

COMMITTEE PUBLIC REPORT

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INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

GENERAL REPORT

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2011 IRPAC Public Report Letter from the Chair

Dear Commissioner Shulman,

As you know, in 1989 Congress recognized the importance of information reporting as a critical function to effective tax administrative, and for the past twenty years the Information Reporting Program Advisory Committee¹ ("IRPAC") has worked side-by-side with the Internal Revenue Service ("Service") to meet this goal.

As legislative action places increased focus on information reporting and its key role in closing the tax gap and bringing all taxpayers into compliance with ever-increasing complex tax laws, the role of the Service and IRPAC becomes even more critical. To meet these challenges, we have organized IRPAC into four subgroups – Emerging Compliance Issues, Burden Reduction, Employee Benefits & Payroll, and International Reporting & Withholding. The key focus areas of the subgroups for 2011 are described below, and we thank the Service for its continuing efforts to address our concerns in these areas:

1. Employee Benefits & Payroll (C. Leonard Jacobs, Chair): This group focused on the reporting implications of health care reform (with immediate consideration for Form W-2 reporting of the cost of health care and longer-range consideration of additional reporting requirements to come). It also worked closely with TEGE regarding reporting concerns raised by the employee benefits community. We appreciate your taking our concerns into consideration and issuing important relief this year in a number of areas, including cell phone relief, establishing a voluntary program for worker reclassification, and extending Form 8955-SSA reporting.
2. Burden Reduction (Kathy Ploch, Chair): This group focused on Form 1099-B cost basis reporting. Although this became effective on January 1, 2011, a number of issues had to be addressed regarding the design of payee statements which will be produced in 2012. The current form design and instructions reflect sensitivity to matters raised by IRPAC that will benefit both recipients and filers. Additionally, we

¹ IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

appreciate your taking our concerns into consideration and in granting relief for 2011 reporting for tax credit bonds on Form 1097-BTC.

3. Emerging Compliance Issues (Candace Ewell, Chair): This group focused on Form 1099-K credit card and third party network reporting requirements, which also largely became effective on January 1, 2011. Although these rules remain fraught with many uncertainties and confusion persists for reporting organizations, we appreciate your taking our concerns into consideration and issuing much needed guidance for the health care industry.
4. International Reporting & Withholding (Donald Morris, Chair): This group focused on working side-by-side with the Service on the implementation of Foreign Account Tax Compliance Act ("FATCA") and on Chapter 3 withholding. With the Service's focus on international issues, we thought it appropriate to similarly dedicate our attention to international issues.

Although a great deal has been accomplished throughout 2011, much work remains. And I urge you to continue to focus on our 2011-2012 Guidance Plan comment letter (see Appendix A), where we emphasized that (1) IRPAC plays a critical role in implementing information reporting and should be consulted early in the process, (2) any changes to information returns takes considerable time and resources, and (3) adding a de minimis dollar threshold (e.g., \$10) with respect to the correction of information returns would significantly reduce taxpayer and Service burdens alike.

IRPAC also supports the efforts of the Office of Servicewide Penalties ("OSP") in its review of the Service's administration of civil penalties, and we look forward to working with OSP as it continues to improve the Service's procedures, including permitting the use of multiple addresses for reporting entities within the IRS computer system to avoid undue delay in response to notices.

Finally, we commend you on your vision to strive for a "real-time" review of Form 1040 filings. Although we appreciate the benefits of such an approach (including fraud prevention), we urge you to consider carefully all the parties involved -- including employers, the Social Security Administration, state tax authorities, information reporting entities, and software companies -- and their limitations and restrictions with any reporting change. Any change in the process (e.g., the flow of information returns, due dates, data exchange between SSA and the Service, a reduction of the number of information documents that trigger electronic filing, etc.) will result in time-consuming and costly programming and system changes, and in some instances, the proposed change may not be viable. That said, we look forward to working with you to address and overcome the challenges and to create a more efficient reporting process.

As my tenure comes to an end, I am confident that IRPAC will continue to serve you well. On behalf of IRPAC, I wish to thank you and the Service (with special thanks to the Office of National Public Liaison) for your continued recognition of the importance of IRPAC, and the ongoing support that allows IRPAC to fulfill its mission to reduce taxpayer burden and improve the overall administration of information reporting.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read 'Elizabeth Thomas Dold', written in a cursive style.

Elizabeth Thomas Dold
2011 IRPAC Chair

Executive Summary of Issues

Employee Benefits & Payroll

A. Employer and Insurer Reporting Under the Patient Protection and Affordable Care Act for Years Commencing on or after 2013

With respect to the above Act and the reporting requirements for employers and insurers, IRPAC has recommendations concerning the use of the Form W-2, Wage and Investment Statement, separate electronic reporting mechanism, streamlining of information requirements, use of a separate form other than the Form W-2 for out year reporting requirements, Medicare tax reporting and more clarity concerning data reporting requirements. We look forward to working with the IRS in the coming year concerning this issue.

B. Health Care Valuation on Form W-2

IRPAC has previously submitted a comment letter concerning the reporting to employees of the cost of group health insurance coverage. IRPAC would like to highlight the need for relief in the area of sick pay reporting.

C. Premium Assistance Tax Credits

IRPAC recommends that the tax credits should be clearly explained in the Fact Sheet released with the proposed rule on August 12, 2011 and the IRS should look to the reporting requirements and how these may be used to assist tax credit applicants.

D. Shared Responsibility

IRPAC requests the IRS to address questions concerning penalty under IRC § 4980H(a) and makes additional recommendations concerning employer's ability to self assess and pay estimated amounts.

E. Form 5500-EZ Registration

IRPAC recommends the development of a voluntary process where a sponsor of a plan that is currently exempt may file a registration statement to receive any informational filings that relates to their responsibility. This voluntary registration is to prevent IRS from issuing failure to file penalty notices when the plan sponsor is under the asset value threshold and has no filing requirement.

F. 5500-EZ Delinquent Filer Program

IRPAC recommends that a program be created to allow delinquent Form 5500-EZ filers to voluntarily disclose the failure to file the information return in a timely manner.

Executive Summary of Issues

G. Employer Identification Numbers for Retirement Plans

With respect to the procedure to obtain employer identification numbers for qualified plans' trusts, IRPAC recommended in our 2010 report changes to the application process. Further, the instructions for obtaining an Employer Identification Number for the above should be clarified, as the current instructions are outdated and confusing. IRPAC also recommends that modifications to instructions and forms be cross-referenced from the Employee Plans website to the EIN landing page.

H. Automatic Extension of Filing Deadlines for TE/GE Issues

IRPAC recommends that the IRS set up a system and maintain a policy that allows for an automatic extension to the original filing date for any form published in final format within four months of its due date for any TE/GE related matter.

I. Clarification Needed on Form 1099-R Instructions

IRPAC recommends the Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., reporting issues relating to the following subjects be clarified: death benefits paid from the employer not reported on Form 1099-R, IRA distributions in box 2a, nonresident aliens, Puerto Rico citizens, and qualified charitable distributions.

J. Form 1099-R Reporting and Withholding Guidance for Certain Installment Payments

IRPAC recommends that the IRS issue reporting and withholding guidance concerning two payment streams from qualified plans, commercial annuities and IRAs covered by IRC § 3405, including lifetime guaranteed payments.

K. Erroneous Claims for Itemized Deductions for Unreimbursed Business Expenses

With respect to the issue of employee unreimbursed business expenses, IRPAC recommends that the Code L in box 12 of Form W-2 be used under certain circumstances to report those expenses reported under an accountable plan. IRPAC also recommends changes to certain publications to aid in the description and understanding of the reporting requirements.

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L. Business Expenses Reporting: Fringe Benefit Information Contained in IRS Publications

IRPAC has provided certain suggested changes to various publications addressing fringe benefits to help clarify the reporting requirements for employees and employers and their obligations.

M. Fraudulent Forms W-2 Result in IRS Issuing Erroneous Tax Refunds Recommendation

IRPAC has explored the issue and makes the following recommendations. IRS should study the occurrence of fraudulent Forms W-2 or Forms 1099 that have resulted in erroneous tax refunds. IRS should team with various stakeholder groups, including SSA and IRPAC prior to implementing changes that will impact individual filers, payers, service bureaus, software vendors, and others affected by any proposed change to the timing, frequency, and/or nature of information reporting. IRS should not implement any change that would increase the frequency of information reporting related to Forms W-2 or Forms 1099. IRS should work with stakeholder groups to determine if shortening the timeframe for reporting payer information would be workable for payers, and, if so, if that change would improve the IRS' ability to reduce the occurrence of erroneous refunds.

N. TIN Masking on Payee 1099s

IRPAC recommends that the optional TIN masking pilot program as referenced in Notice 2009-93 and extended in Notice 2011-38 be made permanent and extended to cover other statements.

Burden Reduction Issues

A. Tax Credit Bonds

Since publication of IRS Notice 2010-28, IRPAC has provided recommendations on tax credit, interest and original issue discount information reporting requirements related to tax credit bonds and stripped tax credits. As this is an entirely new type of reporting, the Burden Reduction subgroup has also worked with the IRS to get a better understanding of the IRS vision for data matching from issuance of new obligations through the claim of tax credits on a taxpayer's return. During 2011 attention has been focused mainly on the requirements of Form 1097-BTC (Bond Tax Credit), a quarterly report to beneficial owners of tax credit bonds. Dialog between IRPAC and the IRS has led to development of a potential data structure framework for filing Forms 1097-BTC using data elements that are routinely captured as part of standard processing by investment firms. If adopted, this should make implementation easier and limit data storage and transmission costs for both filers and the IRS.

Executive Summary of Issues

B. Form 1099-B Modifications for Cost Basis Reporting

The regulations for cost basis reporting necessitate substantial modification to Form 1099-B, Proceeds From Broker and Barter Exchange Transactions. IRPAC has provided consultation and recommendations throughout the year which have led to refinement of the language on the form, improved instructions for taxpayers and filers, provided greater flexibility in the design of substitute statements and improved awareness of the downstream implication of the new requirements. Together, these developments will result in better information for taxpayers.

C. Business Master File Address Change Procedures

Currently, the business address shown on the IRS BMF is changed every time a return is filed. This procedure creates major problems for both the IRS and businesses. The problem lies with IRS Revenue Procedure 2010-16. The IRS will release a new Form 8822-B, Change of Address – Business, in 2012. The new form will help, but will not fully solve the problem. IRPAC recommends that the BMF be changed only by specific written request. We also recommend that the BMF be changed to allow multiple addresses for one business.

Emerging Compliance Issues

A. IRC § 6050W and Form 1099-K Reporting

IRPAC recommends that reporting on Form 1099-K, Merchant Card and Third Party Payments, be made optional for transactions taking place in 2011. This is particularly important in the case of third party network transactions. The reporting rules related to third party network transactions are unclear and require additional clarification and explanation to be effective for many putative reporting organizations. In addition, many reporting organizations simply do not understand that they are potentially implicated by these rules while others understand that their arrangements may be implicated but are burdened by the lack of clear guidance and are, therefore, unable to establish the data processing systems necessary to comply. It has also recently become evident that additional changes to the Form 1099-K are being made, which creates additional burdens that cannot adequately be addressed by reporting organizations in advance of the filing deadlines. IRPAC believes that the IRS must take decisive action now to avert a situation where many currently compliant reporting organizations will be unable to reasonably comply with the new reporting rules as written. IRPAC believes that the IRS must promptly address these concerns in advance of the date on which reporting under IRC § 6050W becomes mandatory.

Executive Summary of Issues

B. Information Regarding IRC § 3402(t) 3% Withholding

IRPAC recommends a public comment period for proposed regulations prior to issuance of guidance for payments made by payment card, clarification of exclusion from withholding for arrangements where service providers remit a payment net of fees to government entities and payments for medical services by third party administrators on behalf of self-funded insurance plans, a proportionate pass through of exemption to government and tax exempt entities that have an ownership interest in a service provider that fails to meet the 80% ownership test, and extension of the good faith exception until after calendar year 2015 along with waiver of the withholding requirement for government entities establishing inability to comply due to IT limitations.

C. Central Withholding Agreements: Addressing Needs of Venues and Foreign Artists Through a Mini-CWA Program and Problems Encountered by Foreign Artists when Applying for US Social Security Numbers (SSNs).

IRPAC began discussions with IRS LB&I regarding Central Withholding Agreements (CWA) in 2010. Issues include addressing the needs of smaller venues with foreign performing artists through the creation of a mini-CWA program and problems encountered by foreign artists when applying for U.S. social security numbers. In 2011, IRPAC has continued to work diligently with representatives of LB&I in their efforts to develop a mini- CWA process, and to address the missing SSN/ITIN concern. A structure for a new simplified CWA has been developed and will ultimately become part of a revenue procedure currently being revised.

D. Withholding and Reporting on Payments for Freight, Shipping, and Other Transportation Expenses under IRC § 1441 and 1442

Significant confusion has long existed regarding the proper withholding and reporting treatment of U.S. source payments for freight, shipping, and other transportation expenses. This confusion relates to the interplay between the 4% excise tax on U.S. source Gross Transportation Income (“USGTI”) under IRC § 887 and the 30% gross-basis withholding tax under IRC §§ 871 and 881 as well as the documentation necessary to establish the responsibilities of withholding agents for the latter. In its 2010 report, IRPAC provided a detailed discussion of this issue and other related issues, including recommendations for improvements to forms and instructions. See Appendix for 2010 IRPAC Report, pp. 12, 61-68. Although the IRS now understands the challenges regarding this issue, little has been done to address these concerns. IRPAC renews the recommendations it made in its 2010 report, recommends a specific change to Form W-8BEN, Beneficial Owner's Certificate of Foreign Status for U.S. Tax Withholding, and also recommends that the IRS promptly correct the discussion of this issue

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included in Publication 515 because the existing discussion is misleading to taxpayers and withholding agents.

E. Information Regarding Form 1098-T Reporting of VA/GI Bill Benefits

IRPAC supports IRS plans to revise the 2012 instructions for Form 1098-T, Tuition Statement, to clarify proper reporting of VA/GI bill benefits.

F. Information Regarding Non-Resident Alien Taxation and Tax Reporting

IRPAC initiated and has continued to support an ongoing effort by the IRS to publish taxpayer friendly web-based content on IRS.gov for non-resident alien taxation, withholding and reporting. So far the IRS has developed a new section titled "Taxation of Aliens by Visa Type and Immigration Status" now in review with Counsel. IRPAC is working with LB&I to develop a landing page that introduces withholding agents to their responsibilities regarding this immigration-based information.

G. Identity Theft and Information Reporting

IRPAC continues to be concerned about the challenges faced by payers in complying with the information reporting requirements where identity theft is involved. IRPAC requested that some clarification be provided to payers to assist their compliance when the payers do not know the identity of the person to whom reporting is required. IRPAC discussed two possible solutions with the IRS: (1) the IRS would add language to all Form 1099 instructions similar to that contained in the instructions to Form 1099-C, Cancellation of Debt, that the form is not required to be filed in cases of identity theft; or (2) the IRS would permit payers to file information returns showing the payee as "unknown payee," similar to what is permitted under the IRC § 1441 regulations. The first solution was not considered technically feasible by the IRS and the second solution will continue to be pursued by IRPAC.

H. Changes to Pub. 3908, Gaming Tax Law and Bank Secrecy Act Issues for Indian Tribal Governments

IRPAC offered language to the Service (TEGE and LB&I) and to Indian Tribal Governments (ITG) to enhance Publication 3908 to assist gaming operations in correctly identifying nonresident alien (NRA) winners for tax withholding and reporting purposes. This IRS publication provides Indian gaming operations with the latest tax law applicable to gaming operations for gaming activities and is widely used by gaming operators across the country. It provides the documentation standards under the Bank Secrecy Act, but failed to address the tax standards for identifying NRA winners. IRPAC supplied the missing information.

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International Reporting and Withholding

A. Foreign Account Tax Compliance Act

IRPAC has worked closely with the IRS and Treasury regarding the implementation of the Foreign Account Tax Compliance provisions of Subtitle A of Title V of the Hiring Incentives to Restore Employment Act (commonly referred to as FATCA). The IRW Subgroup report summarizes the principal issues on which IRPAC has provided recommendations.

A-1. Short-term Debt

FATCA generally imposes withholding and reporting obligations with respect to “withholdable payments.” The definition of withholdable payment includes U.S. source interest (including original issue discount), but does not provide an explicit exception for interest or original issue discount on short-term debt. IRPAC recommends that interest (including original issue discount) on debt having a term of 183 days or less be excluded from the definitions of “withholdable payment” and “financial account” under FATCA, consistent with the terms and policies implemented by the exemption for such amounts under Chapter 3 of the Code.

A-2. Potential Conflicts with Foreign Laws

The obligations that FATCA imposes on foreign financial institutions (FFIs) potentially conflict with legal constraints imposed on such FFIs under foreign law in a number of respects. IRPAC recommends that the IRS take into account the existence of such restrictions in formulating guidance under FATCA.

A-3. Notice 2011-53 Transitional Relief

The IRS issued Notice 2011-53 to provide transitional relief with respect to the implementation of FATCA. The Notice may still leave too little time for financial institutions to build required systems and to perform required account due diligence. IRPAC recommends that the IRS issue further guidance that provides additional time for withholding agents to develop required systems and that provides rules for the identification of FFIs and procedures that withholding agents will be required to follow to verify an account holder is an FFI and its status as a participating FFI.

A-4. Due Diligence Requirements for Existing Accounts

IRPAC recommends that the account holder file searches provided for in Notices 2010-60, 2011-34 and 2011-53 be limited in scope to a reasonable number of calendar years prior to the date of the search.

Executive Summary of Issues

A-5. Revisions of Form 1042-S for FATCA Reporting and Withholding

FATCA will require reporting of additional information concerning types of payments and recipients. IRPAC recommends that the current Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, be revised to include additional income and recipient codes applicable to FATCA reporting and withholding.

A-6. Revision of Form W-8BEN

The current version of the Form W-8BEN is frequently confusing to both foreign entities and nonresident alien individuals. IRPAC recommends that the current Form W-8BEN be split into separate forms for individuals and entities. The new Form W-8BEN for entities should include statements certifying entity classification and other items relevant under FATCA.

B. Chapter 3 Withholding Tax Issues

IRPAC met with the IRS to discuss various Chapter 3 withholding tax issues and offer recommendations. The IRW Subgroup Report summarizes the issues and recommendations. The IRS has indicated it intends to take into account the recommendations in guidance it intends to issue.

C. Clarification of Information Reporting Requirements Relating to Commercial Paper

The HIRE Act repealed IRC §163-(f)(2)(B) of the Code with respect to debt obligations issued after March 18, 2012. The repeal of this provision has created some uncertainty regarding the continued viability of the information reporting exception for commercial paper. IRPAC submitted a comment letter on September 15, 2011 recommending that the IRS clarify the applicability of the information reporting exception for commercial paper following the enactment of the HIRE Act.

**INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE**

**EMPLOYEE BENEFITS & PAYROLL
SUBGROUP REPORT**

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Employee Benefits and Payroll Subgroup

A. Employer and Insurer Reporting Under the Patient Protection and Affordable Care Act For Years Commencing on or after 2013

Recommendations

With respect to the Patient Protection and Affordable Care Act, Public Law 111-148, (the Act) and the reporting requirements for employers and insurers that relate to employee benefit information and employee tax information, the IRPAC has the following recommendations regarding these requirements:

1. The IRPAC recommends that given the potential increase in the data required to be provided to an employee, the IRS should consider the implementation of a separate form other than the Form W-2, Wage and Tax Statement, to report any additional information that may be required to be reported in the future.
2. The IRS should consider developing a separate electronic reporting mechanism for reporting rather than trying to modify the Form W-2 formats, given the complexity of the data.
3. The IRPAC requests that the IRS clarify the process for reporting this information to employees electronically. The information may be accessed by employees in much the same manner as Forms W-2 are currently accessed either through employer portals or other electronic means. This would also include the reporting requirement that becomes effective March 2013 regarding information employers must provide to new employees and current employees.
4. The IRC § 6055 and § 6056 contain several duplicative requirements regarding the reporting of employee and employer information. The committee recommends that the IRS study the potential for providing an optional alternative and streamlining these reporting requirements, while permitting the maximum flexibility with respect to data reporting and reporting methods.
5. The IRS should permit employers to provide for an automated voice response phone system (VRU) as an additional option to the information contact phone number currently prescribed.
6. The IRS should clarify that employers are not required to report health coverage details on any Form W-2 that is issued prior to the January 31 annual due date.
7. The reporting requirements related to this reporting should be defined by early 2012 and no later than June 30, 2013, to permit sufficient lead time for employers and insurers to comply.

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8. With regard to the Medicare tax increase for high earners, we recommend that the IRS report this tax information on Form W-2 in box 9 and on a separate line on the Forms 94x series.
9. The IRS should provide the required information and mechanism for reporting the Shared Responsibility Assessment (SRA) that employers will be required to report after 2013.
10. The IRS should consider allowing employers and providers the option of using the special accounting rule, similar to the reporting of certain fringe benefits, for reporting W-2 health care valuation amounts.

Discussion

1. Given the fact that the Form W-2 already includes as much data as can be reflected on a single page, the inclusion of additional data would undoubtedly cause the form to become a multiple page form. Mid-year plan changes and changes in coverage status, marital status, or dependents may require many data records per employee. The annual processing in this instance, given the fact that the form can be six pages, would make the preparation of the form increasingly difficult and costly. A separate form; e.g. "1099 HC" which would reflect any additional data that may be required in the future would be more efficient. Likewise it would cause less confusion to the employee.
2. Due to the complexity of the information that would be required to be reported, the development of a separate electronic reporting mechanism would be more beneficial than the modification of existing W-2 reporting.
3. Employers will need the ability to report to the employees this information electronically rather than provide the information by paper form. Employers will need the ability to use their existing internal employee benefit electronic portals to disseminate the information. The electronic communication of such statements is a benefit to the employee and also a cost benefit to employers.
4. There exists much duplication of employee data elements to be reported in the applicable sections of the Act. It would be very beneficial for the IRS, insurers, and employers if this information could be optionally consolidated and streamlined so that it is transmitted once using the most efficient method available to the insurer or employer. This would effectively reduce administrative burden and cost for all parties. However, because information is generally stored in separate systems, if not different organizations, the IRS should also permit separate reporting of IRC § 6055 and § 6056 data.
5. In both sections of the Act, the regulations require a phone number for information contact be provided by the employer. IRPAC has in the past

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made several recommendations on this issue. It is very difficult, particularly for large multinational employers, to provide an appropriate phone contact for all employees. Current practice by many corporations of all sizes is to provide VRU. This practice serves the intent of the regulations.

6. It would be extremely difficult for employers to gather the IRC § 6055 health coverage detail information and timely submit the information for those terminated employees who request their Forms W-2 before the January 31 annual due date. In many instances this information must be gathered from third party sources such as insurance carriers. We believe that this information should be reported only on the Form W-2 which is due on January 31 or other form e.g. Form "1099 HC".
7. Reporting of the employee information may be required as soon as February 2014. It is imperative that insurers and employers have ample time to make the necessary system modifications. Much of the data required to be reported is not housed within payroll systems or controlled by the same group that manages the payroll data for Form W-2 reporting. Thus it may be necessary to develop new mechanisms to securely communicate this data between employers, insurance carriers, and affected parties.
8. Based upon discussions that have taken place concerning the reporting of this tax, it seems that the recommendation that was made would create the least amount of administrative and programming burden to employers both from a payroll processing and annual Form W-2 filing perspective.
9. IRS should develop a separate quarterly excise tax return to permit employers to self-assess and report the SRA. Deposit requirements should be established to benefit from a "pay-as-you-go" system, avoiding very large unanticipated annual assessments. There should also be an annual reconciliation of the quarterly SRA filings and the annual reporting of health coverage and full-time employee status under IRC § 6056.
10. Due to the use of third party insurance providers and multiple plans used by employers, it may be difficult to consolidate the various valuations for each plan and incorporate the total on the Form W-2 by the annual filing date. However, if the employer were allowed to use the rule similar to the special accounting rule then the calculation could be made timely and incorporated in the annual form.

B. Health Care Valuation on Form W-2

Recommendation

IRS should exempt sick pay providers from this reporting requirement and otherwise more fully explain who is responsible for the Code DD, Cost of Employer-

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Sponsored Health Coverage, reporting as W-2 reporting is often performed by both employers and third parties.

Discussion

In response to the issuance of interim guidance on informational reporting to employees of the cost of group health insurance coverage (IRS Notice 2011-28), IRPAC submitted a comment letter (see Appendix B) on June 28, 2011, that included numerous recommendations.

IRPAC once again would like to highlight the need for relief in the area of sick pay reporting. Many employers use third party sick pay providers to handle W-2s for short-term and/or long-term disability payments. These providers operate on separate systems from employers and in most cases do not have access to health coverage data on individual employees. This reporting obligation places an undue burden on these providers and employers/plans that would be required to pass along this information from the various health care plan administrators.

C. Premium Assistance Tax Credits

Recommendations

IRPAC makes the following recommendations:

1. The Fact Sheet released along with the proposed rule on August 12, 2011, should clearly explain when the tax credits are available and when they are not available. More examples should be added.
2. IRS should look to reporting requirements already imposed on plans and employers to determine how these may be used to assist tax credit applicants.

Discussion

The Act creates premium assistance tax credits for eligible individuals who purchase health insurance coverage through exchanges, beginning in 2014 (IRC § 36B(b)(1)). The premium assistance tax credits generally are available to individuals with household incomes up to 400 percent of the federal poverty level. The credits are available on a sliding scale. The amount of the credit will be based on the percentage of income that the cost of the insurance premium represents. Premium assistant applicants will be required to report their income to the exchange and this information will be provided to IRS to assist in determining eligibility.

Guidance released in August 2011 as proposed regulations (REG-131491-10) addressed a pressing issue for employers and plan sponsors that needed to be resolved immediately to allow employers to begin future health benefit planning.

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Specifically, the issue was whether family members would be eligible for the tax credits when the employee had access to affordable coverage through the employer-sponsored plan, but the family coverage was unaffordable. We commend IRS for answering this question and seeking public comment.

In addition to the notice of proposed rulemaking released in August 2011, the Treasury Department released a Fact Sheet. While the Fact Sheet is a good start, it does not clearly explain the important issue of when the tax credits are available and when they are not available. The Fact Sheet provides three examples that calculate the value of the tax credit for a family of four. These examples fail to explain that they are based on the assumption that either there is no qualifying coverage or the self-only premium for employer-sponsored coverage is unaffordable. We recommend that this clarification be added to these examples. Other examples are needed illustrating the position taken in the proposed regulations that family members are not eligible for the tax credits when affordable self-only coverage is provided through an employer-sponsored plan, but family coverage is not affordable. These additions will serve to inform the public and permit an open discussion of this issue.

We have many questions and concerns about how IRS will arrive at the eligibility determination for the premium assistance credits given that IRS must have certain information about the individual's employer-sponsored plan. One of the conditions to receive a tax credit is ineligibility for affordable employer-sponsored coverage. We recognize that one piece of the new reporting requires employers and insurers to furnish IRS with plan information by January 31, based on the prior calendar year. Employer-sponsored plans often change from year to year, as premiums, benefits, and cost-sharing are adjusted for medical inflation. The information furnished to the IRS from the employer/insurer reporting return may be irrelevant by the time the IRS receives an application for a premium assistance tax credit.

We understand that as part of the application for the premium assistance credit an individual will provide information on the plan available through their employer. Will the IRS rely on the applicant's representation of the employer-sponsored plan if it differs from the employer/insurer report filed with the IRS no later than January 31? If not, how will the IRS verify the accuracy of the plan information provided by the applicant? The plan information is critical as it is one of the factors determining eligibility for the premium assistance credits.

To address these concerns, the IRS and Department of Health & Human Services should review the new disclosure rules for group health plans (Summary of Benefit and Coverage, RIN 1545-BJ94, Federal Register, August 22, 2011) to determine how these newly required documents could be used to assist employees in answering plan-related questions on the exchange tax credit application.

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D. Shared Responsibility

Recommendations

IRPAC encourages IRS to address the following questions:

1. Will a penalty under IRC § 4980H(a) apply when the employer offers employee-only coverage, but does not offer a family coverage option?
2. Will a penalty under IRC § 4980H(b) apply based on the affordability of self-only coverage and not on the affordability of employee plus one dependent, or employee plus family?
3. Will the employer be required to self-assess the penalty, or will the IRS calculate the penalty and send a penalty assessment to the employer?

IRPAC recommends that employers be permitted to self-assess the SRA at least quarterly, to pay estimated amounts due on a specified schedule, and to reconcile annually against the annual Health Coverage Report under IRC § 6056.

Discussion

The Act imposes different penalties on employers depending on whether they drop coverage or offer unaffordable coverage. We have questions concerning how these penalties will be calculated.

The Act imposes penalties on certain employers that fail to offer their full-time employees the opportunity to enroll in minimum essential coverage under an employer-sponsored plan and have at least one full-time employee who enrolls in an exchange-based plan and receives a premium assistance credit.

The Act imposes a different penalty on certain employers that offer full-time employees the opportunity to enroll in an employer-sponsored plan and have one or more full-time employees enroll in an exchange-based plan and receive a premium assistance credit.

We have raised only a few of the many issues and questions surrounding the premium assistance credits and penalties. IRPAC looks forward to assisting the IRS in exploring these and other issues further.

E. Form 5500-EZ Registration

Recommendation

IRPAC recommends that IRS develop a voluntary process whereby a sponsor of a plan that is currently exempt may file a registration statement in order to receive any informational filings the IRS may have that relates to their responsibility to file Form

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5500-EZ, Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan, or other plan requirements.

Discussion

IRPAC recognizes that many small employers file Form 5500-EZ late because they do not require filing unless certain events occur such as total plan assets exceed \$250,000. A plan sponsor can go many years without the requirement to file Form 5500-EZ. A plan may never need to file Form 5500-EZ until it is terminated or the plan assets exceed \$250,000. Because the plan sponsor has never filed Form 5500-EZ, the requirement to file upon plan termination may not be known.

In lieu of filing a Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan which is a filing under the Department of Labor (DOL) computerized ERISA Filing Acceptance System (EFAST2), IRPAC suggests the IRS develop an annual registration process that is voluntary by the sponsor of the one-participant plan. Because many of these small plans do not retain ongoing service provider support, IRPAC believes this will encourage filing and will promote education within the small plan community alleviating future Form 5500EZ delinquent filings.

F. Form 5500-EZ Delinquent Filer Program

Recommendation

IRPAC recommends:

1. That a program be created to allow delinquent Form 5500-EZ filers to voluntarily disclose the failure to file the information return in a timely manner.
2. That the program be permanent.
3. That any such program should encourage compliance with a penalty structure that supports disclosure of multiple years and/or multiple plan filing failures with a reduced penalty burden.

Discussion

IRPAC believes that there are many delinquent Form 5500-EZ filers that would use a voluntary program to correct filing failures should the IRS create a permanent program for this form. Because one-participant plans may have unintentionally established multiple plans with multiple filing requirements, such a program should be sensitive to reducing the burden on these small businesses. Thus, IRPAC recommends a multiple year and multiple plan penalty structure that is sensitive to the nature of the small business entities that sponsor these plans. The ideal program would encourage small businesses to file delinquent returns with a flat penalty regardless of the number of years or number of plans to be filed.

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Currently, the DOL administers a Delinquent Filer Voluntary Compliance Program (DFVCP) for Form 5500, Annual Return/Report of Employee Benefit Plan, filers other than the Form 5500-EZ. The IRS should establish a permanent program for the Form 5500-EZ filers. There is a distinct burden on small plans that often find themselves with multiple years to file or multiple plans they never realized they had because of the methods used by the financial institutions to establish a one-person plan.

It has been common to find that a plan sponsor has inadvertently adopted multiple retirement plans. As a trustee of the plan would move investments to diversify its portfolio, the financial institution would establish a plan with a different plan number instead of one contiguous plan number. This increases the delinquent filers because each plan would have its own filing requirement. Because the plan sponsor did not intend to sponsor more than one plan, it is a burden on these small businesses to pay a fee for each year and each plan that is delinquent.

Filers of Form 5500-EZ are often delinquent because the requirement for filing may change as the value of the plan assets change or as a new employee becomes an eligible participant. This is unique to the Form 5500-EZ filers. IRPAC requests consideration of this issue in the penalty structure for Form 5500-EZ delinquent filers.

G. Employer Identification Numbers for Retirement Plans

Recommendations

IRPAC makes the following recommendations to the process for employer retirement plans to obtain a trust Employer Identification Number (EIN):

1. Based on the lack of clear guidance on the need and the proper procedure for obtaining EINs for qualified plans' trusts, IRPAC strongly recommended in our 2010 report changes to Forms 5500 and SS-4, Application for Employer Identification Number (and related instructions), to clarify these rules and encourage plan sponsors to obtain a trust EIN for qualified plans/trusts.
2. More specifically, IRPAC suggested clarifying the outdated and confusing instructions for obtaining an EIN for qualified plans/trusts.
3. IRPAC recommended that specific instructions and guidance on the Employee Plan (EP) website be developed regarding the need for and process to obtain a plan's trust EIN, and recommend that the plan's trust EIN be added as an optional box on Form 5500.
4. Although IRS was helpful in promptly adding language to the EIN landing page since the issuance of the 2010 Report, and understanding that it takes time to incorporate changes into the instructions and forms, we recommend that the modifications to the instructions and forms to be issued in the next

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reiteration of these publications include modifications specified in the 2010 report.

5. IRPAC recommends that its suggestions to the forms, instructions, and publications are cross-referenced from the EP website to the various related forms, instructions, and publications that would be helpful in this area.

Please note that this discussion does not alter the approach taken by third party service providers and asset custodians that report using the provider's/custodian's EIN for Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., and Form 945, Annual Return of Withheld Federal Income Tax, reporting, which IRPAC recommends also be reflected on the Form 5500, along with increased IRS clarification on this reporting option.

Discussion

Following IRPAC's 2010 Public Report, the Form SS-4 website landing page for the EIN process was updated with brief language about the nature of the EIN process for employee benefit plans. IRPAC commends the IRS for looking to a prompt method to help clarify the confusion with the retirement plan application process. However, the SS-4 Instructions and Publication 1635, Understanding Your EIN, still need to be updated accordingly with the IRPAC recommendations.

Many small plan employers do not realize that the EIN they use to report earnings for their retirement plan should not be the same as the plan sponsor number. They also do not realize that the process for withholding of pension plan account income tax should not be co-mingled with the payroll of the plan sponsor. IRPAC believes the best way to communicate this is specific information and articles on the EP website.

IRPAC's concern with the communication to sponsors of retirement plans under IRC § 401(a) regarding the need and application process for an EIN for the plan's trust relates to the education process inasmuch as the potential penalties for failing to remit pension withholding in an appropriate manner. Many plan administrators use the EIN given to the plan sponsor for its business, making the tracking of withholding and payments on behalf of plan participants co-mingled with the regular payroll of the employer and thus not separate.

In working with IRPAC the past year, IRS has been helpful in changing the information that is communicated on the landing page for the EIN requirements on the IRS website. We commend the effort to complete the web-based information in a prompt manner.

However, IRPAC also recommends that the instructions for the EIN application process be clear about the need, use, and application process for a separate retirement plan EIN. In order to encourage plan administrators and plan sponsors to obtain an EIN

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for the plan's trust, it is ideal to have guidance contained in the form instructions. Moreover, the instructions should contain examples of the proper use for the EIN, including how to deal with plan and employer mergers and acquisitions.

H. Automatic Extension of Filing Deadlines for TE/GE Issues

Recommendation

IRPAC recommends that IRS establish a system and maintain a policy that allows for an automatic extension to the original filing date for any form published in final format within four months of its due date for any TE/GE related matter. For IRPAC's more global recommendation for changes, see the IRS Guidance Plan comment letter dated June 29, 2011 ([see Appendix A](#)).

IRPAC recommends removal of the signature requirement on Form 5558, Application for Extension of Time To File Certain Employee Plan Returns, because it increases the burden of filing the return timely and accurately. It is inconsistent with historic treatment of data on the Form 5500.

Moreover, IRPAC recommends that the IRS work with the retirement community in implementing new forms and changes to existing forms, and making filing information readily available (e.g., EP website). For example, periodic calls, similar to the payroll community calls, can be established for the retirement community in order to address reporting issues, along with Frequently Asked Questions on the EP website. This approach can be used for Forms 8955-SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits, and 5558, which still have open issues (see below).

Discussion

IRPAC is concerned with the issuance of forms within four months of their original due date. With the added complexity of additional data needed for forms that are issued near an original due date, plan sponsors are not able to turn around the data and have the burden of working with their service providers to collect that data in a timely manner. Should a form be published in its final form within four months of its original due date, the IRS should be able to internally provide for an automatic extension to the form.

In an ideal environment, the IRS would issue forms that do not have material changes prior to this four month benchmark. If this is not possible, the IRS should consider the impact to software vendors and plan sponsors when there is a new form or if substantive changes are made to a form. An automatic extension to the form's original due date anytime a form is published within four months of its due date would provide stability to plan sponsors as well as the service provider and software industry.

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Critical to the use of electronic medium used in today's submission of many information returns, it is very important to understand that software vendors need sufficient time to create the form in proper electronic format, the payer community requires sufficient processing time once forms and instructions are issued in final form by the IRS in order to successfully implement changes to information returns, and employers require lead time to gather and transmit to their service providers the information requested on the information return. Employers are not able to use many forms the day they are finalized and the vendors do not deliver them to employers until they have finalized their software implementation. Internal processing procedures need to be changed by service providers who complete many of these forms on behalf of employers.

Although appropriate and sufficient lead times may vary depending on the extent of the changes to a form and the type of payment, at a minimum the IRS should grant an automatic four month extension of any filing deadline if the IRS issues the final form and instructions within four months of the filing deadline. We believe that this should be a standard of internal IRS practice and not dependent upon practitioner individual and specific requests with each delayed issuance of any information return.

Moreover, once the forms are finalized, the IRS should focus on communicating the changes to the retirement community, and making filing information readily available to facilitate proper tax administration. For example, there are still a number of open issues regarding Form 8955-SSA and Form 5558, and additional guidance would be welcome. Specifically:

Form 8955-SSA:

1. Confirm that no action is needed to take advantage of the January 17, 2012, deadline for 2009 and 2010 plan years.
2. Clarify whether the January 17, 2012, deadline applies to 2011 short plan years, and explain what action should be taken to report while waiting for the 2011 form.
3. Clarify whether a wet ink signature must be kept on file, and if the sponsor signature information in the [Filing Information Returns Electronically \(FIRE\)](#) file (typed name and signed date) are required fields.
4. Clarify what is necessary to meet the participant notice requirement in light of the expansive benefit statements and the lack of clear guidance in this area.

Form 5558:

1. Clarify who is authorized to sign for a Form 8955-SSA extension, and whether that would include the FIRE filer who is the third party service provider.

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2. Clarify what action will be necessary to remove the signature requirement for a Form 8955-SSA extension, as it is extremely burdensome for record keepers and was never previously required for this information.

I. Clarification Needed on Form 1099-R Instructions

Recommendation

In reviewing the Form 1099-R and related instructions, we recommend that the following issues be clarified: (1) death benefits paid from the employer are not reported on Form 1099-R, (2) reporting of IRA distributions in box 2a, (3) reporting for nonresident aliens and Puerto Rico citizens, and (4) reporting of qualified charitable distributions (QCDs) under IRC § 408(d)(8), qualified health saving account (HSA) funding distributions described in IRC § 408(d)(9), and payment of qualified health and long-term care insurance premiums for retired public safety officers described in IRC § 402(l).

Discussion

1. Death benefits from the employer that are not part of the qualified plan are not subject to 1099-R reporting, and the 2011 Instructions for Form 1099-R should be revised accordingly. Specifically, page 1, "Specific Instructions for Form 1099-R" should be revised to delete the second paragraph and page 8 Box 1 "Gross distribution" should be revised to delete the second to last paragraph.
2. There is confusion regarding the 2011 Form 1099-R Instructions on page 8 and page 10, regarding the reporting of IRA distributions in box 2a. The general box 2a instruction says to leave box 2a blank if unable to ascertain the taxable amount, but the specific IRA instructions state that box 2a should be the same as box 1. Therefore, to clarify that IRA distributions should not result in a blank line 2a, IRPAC recommends that the following sentence be inserted on page 8 (following the reference to the blank line): "(For IRA distributions, the preceding sentence does not apply; see Instructions on page 10 "Traditional, SEP or SIMPLE IRA").
3. Reporting of retirement payments to nonresident aliens and Puerto Rico residents should be more fully described in the Form 1099-R and 1042-S, Foreign Persons U.S. Source Income Subject to Withholding Instructions. We understand that international benefit issues are being considered by the IRS, and prior to audit activity in this area, IRPAC strongly recommends that additional education and instructions be provided to plan sponsors as to the proper reporting for all types of participants covered by U.S. tax qualified plans/IRAs.

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4. Please confirm that no special rule apply to QCDs under IRC § 408(d)(8), HSA funding distributions described in IRC § 408(d)(9), and payment of qualified health and long-term care insurance premiums for retired public safety officers described in IRC § 402(l). Page 1 of the 2011 Form 1099-R Instructions indicate that no special reporting applies, which we assume means that these payments are reported as otherwise taxable distributions under the applicable provisions, and that January QCDs are not separated from other QCDs. We note that some may take the position that there is no 1099-R reporting on IRC § 408(d)(9) transfers because it is a trustee-to-trustee transfer that is not reportable. Additional clarification is needed.

J. Form 1099-R Reporting and Withholding Guidance for Certain Installment Payments

Recommendation

IRPAC recommends that the IRS issue reporting and withholding guidance on two types of payment streams from qualified plans, commercial annuities, and IRAs covered by IRC § 3405, collectively, the "accounts", and that this guidance be prospective in nature, as IRPAC anticipates that based on the lack of clear guidance in this area, varying methods have been adopted.

The first payment stream from an account is installment payments that are a fixed dollar amount paid at least annually and are scheduled to be paid out until the account is exhausted, i.e., if no subsequent participant action is taken, the payments will be paid over at least 10 years, but that the participant can stop these payments at any time, and these payments may include a one-time upfront election by the participant to include a fixed annual increase for inflation.

The second payment stream is a lifetime income guaranteed payments from an account paid for the life of the participant, which generally can also be modified or stopped at any time by the participant, at least until the account balance is zero.

Discussion

IRC § 3405 provides for mandatory 20 percent withholding on eligible rollover distributions, and voluntary wage withholding for periodic payments that are not eligible for rollover treatment. An eligible rollover distribution excludes any distribution that is one of a series of "substantially equal periodic payments" made (not less frequently than annually) over any one of the following periods: (1) life of the employee/beneficiary, (2) life expectancy of the employee/beneficiary, or (3) a specified period of ten years or more. For this purpose, in the case of payments from a defined contribution plan to be distributed in annual installments of a specified amount until the account balance is exhausted, the period of years is determined using reasonable actuarial assumptions. Treas. Reg. § 1.402(c)-2, Q&A-5(d).

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Regarding the cost of living adjustment, several private letter rulings support a one-time upfront election of three percent without a loss of "substantially equal" status, e.g., Private Letter Rulings (PLR) 9747045, 9536031. Moreover, the legislative history to IRC § 72(t) states that a series of payments will not fail to be substantially equal solely because the payments vary on account of "certain cost-of-living adjustments" and that "the Secretary may prescribe regulations setting forth other factors (consistent with the factors that preceded under IRC § 401(a)(9)) that will not cause payments to fail to be considered substantially equal." 1986 Act Blue Book, at 717. The IRC § 401(a)(9) regulations for annuity payments from a qualified trust under a defined benefit plan expressly permit an increase by a constant percentage, at a rate that is less than five percent per year. Treas. Reg. § 1.401(a)(9)-6, Q&A-14.

In contrast, however, PLR201120011 provides that, for purposes of § 72(q), a constant one to four percent adjustment, as elected by the participant, results in loss of "substantially equal" status. Its analysis is focused on the belief that (1) the adjustments fall outside of IRC § 401(a)(9) account balance rules described in Revenue Ruling 2002-62, which was intended as relief following Notice 89-25, which Notice has historically been viewed as only a safe harbor method to meeting these requirements, and (2) a participant's election of between one and four percent annual increase was not a cost of living adjustment. Notably, these payments and the qualified plan payments are reported on Form 1099-R.

Although this 2011 ruling addresses only IRC § 72(q), there is a concern that as the same "substantially equal" requirement applies for IRC § 72(q), 72(t), 402(c), and 3405, this ruling signals a potential IRS change in the proper reporting and rollover approach (to mandatory 20 percent withholding and eligible rollover treatment) for installment payments from qualified plans. However, prior to undertaking extensive re-programming and distribution changes and trying to explain potentially a different rollover and withholding treatment depending on whether the annual three percent adjustment is elected, the reporting community needs to understand from the IRS the full impact of this ruling to all accounts.

Moreover, there is no guidance on the proper treatment of guaranteed lifetime payments for purposes of IRC § 72(t), 402(c), and 3405. It is important to understand the proper reporting as the payer may be liable if insufficient withholding is taken, along with potential reporting penalties under IRC § 6721 and § 6722, and the participant may face an annual six percent excise tax if the amounts are improperly treated as eligible for rollover and rolled to an IRA.

K. Erroneous Claims for Itemized Deductions for Business Expenses

Recommendation and Discussion

IRS officials have indicated that there has been a problem with individual taxpayers claiming itemized deductions for unreimbursed business expenses when filing Forms 1040, U. S. Individual Income Tax Return. IRPAC has explored this

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problem and offers the following recommendations to enable IRS to be better positioned to identify these types of situations where an individual who is reimbursed for a business expense also claims an itemized deduction for the very same item:

1. IRS should obtain data on the scope/risk of erroneous claims for business expenses. IRS should perform a study to determine the current level of non-compliance in this area to ascertain if the cost of changes to improve compliance would be outweighed by any additional benefit. IRS should consider costs to employers, service providers, and software developers, as well as costs to IRS. All of the above mentioned stakeholders would incur additional programming, processing, and procedure costs as a result of a change to improve compliance.
2. IRS should review the use of current Code L, Substantiated Employee Business Expense Reimbursements, in box 12 on Form W-2 and consider modifying the requirement for Code L such that employers would indicate whether or not the employer has an accountable plan in place for reimbursement of qualified business expenses. For example, a ‘Y’ could indicate that such a plan was offered during the tax year; and an ‘N’ could indicate that such a plan was not offered. The indicator could be at the EIN/employer level, or at the individual employee-level, or at some other level, e.g., employee pay grade, division, group, etc., that is feasible for the employer to provide. Alternatively, the employer could indicate Y if an accountable plan was offered, and otherwise, the box L indicator would be blank. This latter suggestion, i.e., Code L Y; or leave blank, would likely be less burdensome to employers, especially small business since small businesses would be less likely than large business to have an accountable plan. However, this approach would need to be in conjunction with recommendations number six and seven below. IRPAC prefers use of box 12 to a new box as a change to box 12 would likely require less implementation cost and effort by stakeholders involved in Form W-2 processes.
3. IRS should not require that the employer post any new dollar amounts for payments made under an accountable plan on Form W-2 than are now required. The payroll system or payroll service provider does not typically have information or data on these types of payments. Reimbursements made under an accountable plan are typically made through an accounts payable system, a travel reimbursement system, or a third party. These do not typically interface with the payroll system or provider issuing Form W-2. Requiring the posting of these types of payments onto a Form W-2 would require expansion of payroll systems to house the amounts, extensive programming, as well as costs for testing, implementation, and process and procedure changes.

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4. IRS should review the current use of Code L in box 12 on Form W-2 with respect to per diems and mileage allowances, and IRS should continue such reporting only if IRS deems that this information is useful to IRS in its compliance efforts. If so, the accountable plan indicator, Y or N in the section above; or Y and blank, could be incorporated into box 12 of Form W-2 in some other fashion.
5. IRS should then consider tailoring its identification of situations where an individual claiming an itemized deduction for unreimbursed business expenses was in error to those in which Code L indicated a Y. Here, the company offered an accountable plan, and it may be the case that the amount claimed by the individual as an itemized deduction had also been reimbursed by the employer. Note however, that even if an employer offers an accountable plan, the individual may not have, in fact, been reimbursed and the claim for an itemized deduction may have been appropriate. In any event, this change may make it easier for IRS to identify potential problem situations.
6. IRS should stress in its audit guide procedures that the individual, not the employer, is responsible for providing proof of the appropriateness of any claim for an itemized deduction on the individual's income tax return. The employer should not be burdened with responding to IRS or employee inquiries regarding positions taken by the employee on his/her individual income tax return. The employee is required to substantiate the appropriateness of the deduction that he/she took on his/her return and should not otherwise contact the employer.
7. IRS should state in the IRS audit guide that if the employer has an N under Code L or the indicator was blank, the revenue agent should not need to ask the employee to obtain from the employer a letter of certification that the employee was not reimbursed for expenses.
8. IRS would also need to consider the need to modify language with respect to accountable plans, per diems, employer reimbursements, etc. in a variety of documents, such as Publication 535, Business Expenses, Instructions to Schedule A, Itemized Deductions, to Form 1040, IRS Publication 15, Circular E, Employer's Tax Guide, IRS Publication 463, Travel, Entertainment, Gift, and Car Expenses, as well as language in Instructions to Form W-2.
9. Prior to making any such change, IRS should team with various stakeholder groups, including employers, payroll service providers, software developers, and IRPAC, to ensure that requirements are workable and, if so, would the changes improve the IRS' ability to reduce the occurrence of erroneous claims for itemized deductions for reimbursed business expenses.

IRPAC welcomes the opportunity to work with IRS on this issue.

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L. Business Expenses Reporting: Fringe Benefit Information Contained in IRS Publications

Recommendation

IRS officials from the Large Business & International operating division (LB&I) requested IRPAC's suggestions on information reporting related to a variety of noncompliance items in the area of business expenses and fringe benefit reporting. Based upon discussions with LB&I representatives and the IRPAC, the following are recommendations regarding each issue discussed:

1. IRPAC reviewed the IRS publications noted in the discussion below and provided recommendations regarding language enhancements.
2. For non-compliance in reporting stock option compensation, IRPAC recommends that a dedicated section of an IRS publication be used to explain both the employer and employee reporting obligations.
3. IRPAC recommends that no additional form be considered at this time due to the fact that it would increase burden and costs to the IRS and the reporting community. IRPAC welcomes the opportunity to provide additional suggestions to IRS on these topics.

Discussion

IRPAC review of IRS Publications

IRS officials from the LB&I requested IRPAC's suggestions on information reporting related to a variety of noncompliance items in the area of business expenses and fringe benefit reporting that have been identified during recent audits. IRPAC reviewed a number of IRS publications that contain information on the reporting requirements for these issues. Generally, IRPAC found that, in each of these publications, there was a varying degree of explanation of business expenses, how they are to be reported by the employer, what amounts are reportable as wages versus non-wages paid to the employee, and how to report on the employee's Form W-2. IRPAC suggested a number of clarifications and recommended that IRS review and edit these publications with the aim at enhancing the use of standard language terms and the use of examples/charts to reflect that reporting.

Below are some comments on the IRS publications reviewed:

IRS Publication 15 (Circular E), Employer's Tax Guide:

1. Section 5 of Publication 15 on page 12 uses the term "specified amounts" (for example, nontaxable portion) in box 12 of Form W-2 using Code L.

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IRPAC suggests that it would be more beneficial to use the term “substantiated amounts” which is used in other publications.

2. Instructions for Forms W-2 and W-3: inconsistencies in wording:
 - a. Page 5 states that where the employer uses a per diem or allowance and the amount paid for “substantiated miles or days of traveled exceeds the amount as substantiated under the IRS rules, you must report as wages on Form W-2 the amount in excess of the amount treated as substantiated. Report the amount treated as substantiated in box 12 using Code L”.
 - b. Page 11 provides that Code L should be used only if the employer reimbursed its employee for employee business expenses using a per diem or mileage allowance method and the amounts that the employer reimbursed exceeds the amount treated as substantiated under IRS rules. See section above page 5. Also, on page 11 in the first part of the sentence, suggestion is to state that the employer use the Code L only for substantiated amounts if the employer reimbursed its employee for employee business expenses. It would be better to use the same term (i.e., substantiated amounts) here as was used on page 5 and last part of the sentence on page 11.

IRS Publication 463, Travel, Entertainment, Gift, and Car Expenses:

IRS Publication 463, addresses items impacting Form 1040 filing and Form 2106, Employee Business Expenses. It includes a chart on page 30 on how expenses are reported on Form W-2 and Form 2106. The chart should be modified to address the reporting when the employer offers an accountable plan and reimburses employees for actual expenses.

IRS Publication 525, Taxable and Nontaxable Income:

The suggestion is to include on page 3 of IRS Publication 525 references to the Instructions to Form W-2, Code L, along with the references to Publication 463.

IRS Publication 535, Business Expenses:

IRS Publication 535 addresses items also discussed in Publication 463. IRPAC suggests that both publications (1) include information on the reporting treatment when actual business expenses are reimbursed through an accountable plan, (2) include language addressing the fact that there is no required reporting on Form W-2 if the excess reimbursements, beyond actual business expenses are returned to the employer, and (3) incorporate the same terminology for the same item, e.g., substantiated amounts and excess amounts. In addition, the chart in IRS Publication

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535 on Form W-2 reporting would be clearer if it separated the Form W-2 treatment of wages reported in box 1 and the amount reported in box 12 under Code L.

Non-compliance stock option compensation reporting in Forms W-2 or Forms 1099:

This guidance should include reporting for former employees on Form W-2 and for non-employees, such as directors, on Form 1099-MISC, Miscellaneous Income. This section should also describe the impact of the new cost basis reporting rules, and the employee's basis in the stock, and cover the variety of available forms of equity based compensation. See IRPAC's comment letter dated February 26, 2010 for a summary of the various equity based compensation arrangements, applicable rules, and available IRS guidance.

Payments made to lobbying firms:

With respect to the difficulty that IRS is experiencing when attempting to identify payments made to lobbying firms as these payments are nondeductible by the payer, IRPAC considered if it would be beneficial to require a special Form 1099 for these payments to lobbying firms, e.g., Form 1099-LOBBY. IRS should conduct a study to assess the level of noncompliance in this area before review of a new special Form 1099.

M. Fraudulent Forms W-2 Result in IRS Issuing Erroneous Tax Refunds Recommendation

IRS officials have indicated that there has been an increasing incident of erroneous tax refunds being issued based on individuals' submission of fraudulent Forms W-2 and/or fraudulent Forms 1099. The problem is exacerbated by the timing of when the refunds are issued and when IRS receives the actual employer Forms W-2 and payer Forms 1099. Due to the statutory filing dates, individuals file returns and receive refunds, in many cases, in advance of the IRS' receipt of payer data. IRS has taken some steps to confirm or validate individual filings that appear fraudulent. For example, IRS contacts the employer/payer individually by phone or fax to request a manual verification of a suspicious Form W-2 or Form 1099. Verification is not all inclusive and is very time and labor consuming for both the IRS and the employer/payer. Some employers have responded by providing IRS with a duplicate of the W-2 file submitted to the SSA. The steps can be burdensome to employers and payers issuing Forms W-2 and Forms 1099, and, IRPAC understands these steps have not been especially effective at addressing the problem.

IRPAC has explored the issue and makes the following recommendations:

1. IRS should study the occurrence and scope of fraudulent Forms W-2 or Forms 1099 that have resulted in erroneous tax refunds. This data will be

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important to ensure that the cost and burden of any additional controls are outweighed by the benefit to IRS.

2. IRS should team with various stakeholder groups, including SSA and IRPAC, prior to implementing changes that will impact individual filers, payers, service bureaus, software vendors, and others affected by any proposed change to the timing, frequency, and/or nature of information reporting.
3. IRS should not implement any change that would increase the frequency of information reporting related to Forms W-2 or Forms 1099. Specifically, IRS should not implement quarterly wage and tax reporting as payer and payroll systems are configured to create and issue Forms W-2 annually, at the conclusion of the calendar year. Any requirement for more frequent reporting, e.g., quarterly reporting, would be a very significant change and unlikely to be implementable given that payers must gather a wide variety of data from other sources and vendors in order to comply to complex Form W-2 reporting requirements, e.g., fringe benefit, retirement plan, and health care information must typically be collected from non-payroll sources for Form W-2 reporting purposes.
4. If more restrictive filing deadlines are considered, IRS should work with stakeholder groups to determine if shortening the timeframe for reporting employer/payer information would be feasible, and, if so, if that change would improve the IRS' ability to reduce the occurrence of erroneous tax refunds being issued based on individuals e-filing fraudulent returns. For example, employers have until March 31 to e-file Forms W-2 data with the SSA. It could be determined that these returns could be filed sooner, for example, February 15. However, IRS should note that Forms 1099 are unlikely to be able to be filed more quickly due to information gathering and processing issues related to Forms 1099.
5. IRS should work with stakeholders in the payer and information reporting communities to assess if a reduction to the threshold of returns required for e-filing would be helpful in reducing instances of fraudulent tax refunds. IRPAC recognizes that any such change would likely require a legislative change. Currently, employers and payers issuing more than 250 Forms W-2 are required to file electronically with the SSA. IRS should evaluate whether lowering this limit would reduce fraud. A change to the limit below 50 Forms W-2 would likely have an adverse taxpayer burden impact on small business. Even a less dramatic reduction could have a negative impact. IRS should work with SSA to increase the number of Forms W-2 that employers can file free of charge through the SSA website from the current limit of 20 forms to a greater number, e.g., 50 forms. Such a change might be helpful since we

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understand that there has been a greater incidence of fraudulent returns and reporting errors with paper Forms W-2. Currently, approximately 40 million Forms W-2 are filed on paper. IRS should also encourage its stakeholders who are software vendors working with Form W-2 filings to enhance output files sent to SSA to enable more seamless filing of Forms W-2. These suggestions are aimed at addressing the concern that employers, especially small business, could be impacted with increased burden if the threshold was lowered.

6. IRS should work with SSA to assess how changes to reporting between the two agencies could be made that will help reduce fraud while not increasing taxpayer burden.
7. IRS should consider if receipt of a simple data file for Form W-2 verification could be helpful in reducing the number of fraudulent tax refunds. The suggestion is that the employer could, at the employer's option, send a stripped file to IRS (Name, SSN, and EIN) to allow the IRS to verify the existence of the Form W-2 prior to issuance of a refund. The suggestion is that the employer could issue this stripped file annually in early January to IRS (the file would not include wage and tax information). The return to the employer of sending this file is that the IRS would not contact the employer via phone or fax requests for individual Form W-2 verification.
8. Alternatively, employer could, at the employer's option, send a duplicate file to IRS (in the same format and at the same time as sent to SSA) for verification only. This would allow IRS to verify the W-2 prior to issuance of any refund. The return to the employer would be that it would eliminate IRS contacting via phone or fax requests for Form W-2 verification after file was received. Currently, some employers are doing this with IRS. However, this may not be especially helpful since the employer filing to SSA is currently not required until March 31.
9. IRS should work with stakeholder groups to determine additional algorithms of data combination, and situations that, if reported on a Form 1099 or Form W-2, could suggest that there is a fraudulent return. IRS' systems could be programmed to catch such potential problems and avoid issuing a fraudulent tax refund. Review with stakeholder groups might alert IRS to situations that IRS had not previously contemplated.

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Discussion

Employers are required by law to file Forms W-2 to the SSA by February 28 following the close of the tax year. The filing deadline is March 31 if the employer e-files these Forms W-2 to the SSA. The SSA processes the data and performs a number of edit and validation routines to scrub and perfect the data to ensure that the data is as accurate as possible prior to posting the individual records to the SSA's database and before passing the data to IRS. IRS starts receiving Form W-2 data weekly from SSA in January following the close of the tax year, but most of the data is not received until March or April. The timing of when the data is available to IRS for use in field audits is key to IRS being able to identify potentially fraudulent Forms W-2 prior to issuance of an erroneous tax refund.

Employer/payer and individual filing due dates and filing requirements are set by law. Employers and payers have established business processes and systems geared to compliance with these legal requirements. U.S. taxpayers are accustomed to filing individual tax returns by April 15 and many are accustomed to filing as early as possible (e.g., in early to mid-January) in order to obtain their tax refunds as quickly as possible.

IRPAC understands that the problem with issuance of fraudulent tax refunds should be addressed. However, many stakeholders may be affected by changes aimed at reducing fraudulent tax refunds. Changes that would impact employer/payer responsibilities, business processes, and systems, and changes that would impact individual taxpayers' early receipt of their refunds are major changes that would require thorough exploration with stakeholder groups and evaluation of the costs and benefits of any such change. IRPAC welcomes the opportunity to work with IRS on these important issues. We note that this issue should also be considered as the Commissioner's vision of real-time returns is studied.

N. TIN Masking on Payee 1099s

Recommendation

IRPAC recommends that the optional TIN masking pilot program set forth in Notice 2009-93, and extended in Notice 2011-38, be made permanent, and expanded to cover: (1) other types of payee statements (including Forms 3921, Exercise of an Incentive Stock Option Under Section 422(b), 3922, Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c), and W-2 (although we understand that a statutory change is required for this change), (2) electronically furnished payee statements, and (3) truncation of a payee's EIN.

Discussion

Please see IRPAC's 2010 Report and our comment letter dated December 17, 2009, for additional information.

**INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE**

**BURDEN REDUCTION
SUBGROUP REPORT**

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Burden Reduction Subgroup Report

A. Tax Credit Bonds

Recommendations

To establish a robust system of information reporting with regard to tax credits earned on tax credit bonds issued under IRC § § 54, 54A, 54AA or 1400(l) IRPAC recommends that the IRS adopt an approach in which middlemen and other nominees, bond issuers, and taxpayers report sufficient information to allow the IRS to ensure that the tax credits available to the beneficial owners are not over claimed. To the extent possible, this should be accomplished by relying on information that is available to each party without extraordinary efforts and without creating data flows that are superfluous. Central to this objective is the unique identification of entitlement in the information returns and tax returns that are filed through a chain of nominees. Toward that end IRPAC specifically recommends:

1. Removal of the quarterly identifier from Form 1097-BTC. (Bond Tax Credit)

IRPAC believes that the current draft of Form 1097-BTC should be modified to exclude the unique identifier associated with each credit allowance date in favor of a single box for account number or equivalent established by the filer. When this value is considered in conjunction with the combination of the filer's employer identification number (EIN), the taxpayer identification number and the credit allowance date, it creates a unique index through which associated aggregate value of tax credits may be sufficiently tracked.

2. Careful consideration of the granularity required for annual reporting that will be matched to the taxpayer's return

Form 1097-BTC is intended to be furnished to the beneficial owner on a quarterly basis and filed with the IRS annually. IRPAC, therefore, additionally recommends that in developing the associated electronic filing requirements for issuers of Form 1097-BTC the granularity of the data is carefully considered. For example, if taxpayers will not be required to separately account on a tax return for the tax credits associated with each calendar quarter, there would be no need to require anything beyond annual totals on the filing with the IRS of the 1097-BTC because no opportunity for quarterly reconciliation exists.

Discussion

Tax credit bonds and the associated stripped tax credits present a variety of challenges for information reporting. IRPAC has previously provided substantial commentary on this topic that was incorporated into the 2010 Public Report. For 2011, consultations with the IRS were limited to the reporting regime for tax credits.

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The discussions on this topic are ongoing. Most recently, IRPAC agreed to provide additional recommendations regarding the following related questions.

1. **Trade fails**

For a contracted sale of a tax credit bond, what are the implications if the seller has failed to deliver the bonds to the buyer and a credit allowance date passes? Are there substitute tax credits? How should they be reported? What is the impact to the IRS attempt to account for all credits being claimed?

2. **Enterprise level reconciliation**

Part of the projected approach to tracking tax credit claims is to have taxpayers provide an annual reconciliation with their tax returns. What is the most reasonable and effective approach for taxpayers such as financial institutions that are both beneficial bond owners as well as a nominee for other beneficial owners to whom they have reported tax credits on Form 1097-BTC?

3. **Corrections**

Form 1097-BTC as currently structured contains the usual IRS convention of a check box at the top of the form to indicate when a form is a corrected version. The 1097-BTC is unique because payers are required to report quarterly to beneficial owners, but only annually to the IRS. Further, the form has a separate box for the amount of tax credit applicable to each calendar quarter. What is the most effective way to distinguish to a recipient whether a correction reflects a change to a previous quarter or reflects a corrected annual filing with the IRS?

Issues regarding information returns for accruals of original issue discount (OID) on stripped tax credits remain a work in progress. IRPAC provided recommendations to the IRS on this matter in 2010 and looks forward to contributing to development of a successful reporting regime for these and other tax credit bond events in 2012.

B. Form 1099-B Modifications

Recommendations

Cost basis regulations have introduced several new concepts and reporting requirements which call for changes to the Form 1099-B, Proceeds From Broker and Barter Exchange Transactions, and amended guidance for substitute forms (payee statements) in IRS Publication 1179, General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, W-2G, and 1042-S. IRPAC has made many recommendations to the 1099-B and substitute form instructions, as well as the corresponding Schedule D, Capital Gains and Losses, and Form 8949, Sales and Other Dispositions of Capital Assets, to be part of the taxpayer's Form 1040 filing. The key comments on Form 1099-B are set forth below:

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- 1. Exempt inclusion of certain gains and losses on the 1099-B and expand instructions to explain when offsetting the basis from gross proceeds would not result in the correct taxable gain or loss.** The larger number of these events involve reorganizations, but there are other cases such as after certain short sale adjustments and when involving certain S Corporation transactions, to name a few in a fairly long list that was outlined in IRPAC's initial comments in 2009 Public Report. IRPAC provided the IRS with several examples where the end result would be different from the instructions. The initial 2011 version of Form 1099-B included a box for reporting the gain or loss on a tax lot closed during the year. The corresponding instructions advised the recipient that the reported amount was the result of the difference between reported gross proceeds and the reported cost basis. Ultimately, the IRS removed the requirement to report the amount of gain or loss entirely.
- 2. Provide the payer community instructions with examples for reporting reorganizations.** Although the box for reporting gains or losses was removed, instructions with examples are still needed to assist the payer community in correctly reporting transactions involving reorganizations. The final version of the cost basis regulations [Reg. §1.6045-1(a)] makes clear that shares distributed in a reorganization can be "covered" for cost basis reporting. In addition, taxable payments (boot) remain reportable on the 1099-B. IRPAC has explained to the IRS the diverse industry practices and has provided the IRS with the examples that need to be addressed in instructions to assist payers in correctly and uniformly handling these events.
- 3. IRPAC maintains its recommendation that the payee instructions to the 1099-B specifically acknowledge that the recipient might not be able to independently compute the amount of gain or loss using information found solely on Form 1099-B,** such as in the context of wash sales that occur in several accounts or between accounts held at different institutions, and to clearly state that it is the taxpayer's responsibility to file a correct tax return.
- 4. Make the substitute payee statement instructions flexible enough to accommodate information beyond the requirements of the official form under the new cost basis provisions.** In addition to phasing in cost basis reporting over three years, the legislation established the concept of covered and noncovered tax lots. Reporting requirements differ for the two, with the more rigorous requirements applying to covered lots. In many instances filers may have information that is useful to the taxpayer, but is not required on the Form 1099-B. Revenue Procedure 2009-49 (the most recently published guidance for substitute Forms 1099) prohibited the inclusion, within a substitute form, of information not required by the official form, and if the instructions remain the same, the payer community will be

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forced to supply cost basis information in several places in their yearend tax statements to their clients or even in separate mailings. This will make for a very burdensome filing process and may result in the taxpayers filing an incorrect return. IRPAC recommends, therefore, that filers of substitute forms be permitted to display information that is not required by the form or is not reported to the IRS due to the lot's noncovered status along with the required information as long as the statement clearly reflects what is being filed with the IRS.

5. **IRPAC continues to recommend that the IRS provide corresponding guidance on disclosures and descriptions used to alert form recipients which information is not reported to the IRS.** With this flexibility, filers will be able to make clear what type of transaction (merger, tender, put, sale, etc.) is being reported, include any special considerations such as the redemption of a contingent payment debt instrument, indicate whether the amount reported reflects option premium, identify the lot relief method employed and annotate complex corporate actions.
6. **With only a few months left in 2011, flexibility in substitute form instructions will be important as the payer community works through their own systems to comply with fairly complex cost basis reporting requirements.** Over the next few years every filing season will bring new limitations which will make substitute form development difficult. For 2012, mutual funds and dividend reinvestment plan shares become covered, and reporting debt obligations and options will be required in 2013. This information is already covered in many payer yearend tax statements. Although the return preparer community has asked that the payee statement be made uniform, IRPAC notes that cost basis information has been supplied for decades and that many systems are fairly sophisticated and are different. Many will not be able to conform to radical changes in their layouts except over time. Flexibility will be very important as we move forward.
7. **Specifically, IRPAC recommends allowing the format of substitute Forms 1099-B to logically group information into sections such as long term and short term rather than provide repetitive, distinct declarations on each reported item.** When designing substitute Forms 1099-B, there are several required elements that would best serve as the foundation for sorting and grouping reportable amounts rather than as data elements that are repeated line after line. In lieu of an indication of a term on each line item, the section in which like tax lots were grouped would be clearly labeled as "long-term" or "short-term." Within these groupings, designation of whether basis is reported to the IRS should also be handled in this manner. Similarly, allowing CUSIP number and security description to appear a single time within a section as the heading to a series of closing transactions for that security creates an efficient presentation for the

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recipient and also frees space within each line for reporting the newly required data elements of date of acquisition and cost. With reporting on a tax lot rather than transaction level, these considerations have greater importance because they have a moderating effect on the inevitable increase in printed pages. Any official guidance that helps to restrain cost and environmental impact (cutting down the paper bulk and mailing cost) while providing taxpayers with a robust substitute information return is welcome. IRPAC provided a mockup of a substitute Form 1099-B to illustrate these points. [See APPENDIX C]

8. **To more accurately describe the information found on Form 1099-B, IRPAC recommends** removing reference to price (a unit concept) in favor of proceeds (a transaction concept).
9. **References on Form 8949 should be changed to reflect whether cost basis was reported to the IRS rather than whether it appears on the 1099-B.** Recognizing the additional data reported on Form 1099-B, the IRS introduced Form 8949, an adjunct to Schedule D that a taxpayer includes with his or her return. The initial draft of Form 8949 distinguishes between items for which cost basis appears on the 1099-B and items for which it does not. In light of the need for flexibility to include items on the payee statement (substitute 1099-B) that are not reported to the IRS as explained above, IRPAC recommends that references on Form 8949 be changed to reflect whether cost basis was reported to the IRS rather than whether it appears on the 1099-B.

Discussion

The most recently published instructions for filers of Form 1099-B provide an initial indication of the IRS's concurrence with these initiatives and IRPAC looks forward to their incorporation into the more formal guidance of Publication 1179 for 2011.

Regulations covering inclusion of cost basis and other related information on Form 1099-B have created a new paradigm for information reporting. Previously, sales of securities (or other dispositions) were reported to the IRS at the transaction level. Any number of tax lots owned by an investor could be sold and reported as a single transaction. Of course the tax liability had to be calculated by the taxpayer on a lot by lot level and many financial service firms provided, as a courtesy, a separate, more granular report to their clients to assist with that responsibility.

With the advent of the new cost basis regulations, the style of reporting that was previously provided as a courtesy essentially becomes the requirement, raising the need to distinguish between covered and noncovered lots as defined by the regulation. The report that financial service firms have been providing to their customers collectively contains both covered and noncovered securities and to comply with the

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new reporting requirements governing substitute/composite statements may pose a variety of challenges.

Information that is needed by the taxpayer to complete Schedule D and Form 1040 will sometimes be required by Form 1099-B and sometimes will not. This distinction is understandable as it provides different requirements for covered and noncovered lots during the transition to more robust 1099-B reporting. There are many instances, however, where brokerage firms have information available that should be presented to the payees regardless of whether there is a regulatory requirement. This information consists primarily of the data elements that are required for covered tax lots. There is no logical reason to segregate this information, creating a mixed bag presentation of information. Consider an investor that sold in a single transaction, a covered and a noncovered lot of the same security which both result in long term capital gains. When completing his or her tax return, should that investor be required to find the relevant cost basis information in separate places in a single document? Would such a presentation improve the chances of the investor reporting the gain or loss correctly? IRPAC believes that the flexibility to present each of these in the same way, in the same document organized to coincide with the tax return requirements is essential.

We also note that in recent years information reporting requirements have introduced considerable flexibility in the presentation of complex information similar in scope to the new requirements of the 1099-B. Consider, for example, reporting for Widely Held Fixed Investment Trusts (WHFITs) as described in § 1.671-5(e). Under these regulations, trustees or middlemen are not required to provide a payee statement. Rather, the requirement is that for a trust interest holder (TIH) for whom a 1099 is filed with the IRS a “written tax information statement” must be supplied. This statement is required to include all the information contained in the Forms 1099 and “...any other information necessary for the TIH to report, with reasonable accuracy for the calendar year...” items of income, credit or expense to which he or she is entitled. This broad language (along with the introduction of the additional written statement in lieu of a payee statement) seems to be acknowledgement that inclusion of relevant detail and representation of the information for certain investments should not be artificially constrained.

IRPAC, with the recommendations contained herein, is seeking to reconcile the willingness of the financial services firms to serve taxpayer needs with the IRS’s requirements for arrangement and presentation of information on substitute/composite Forms 1099-B.

C. Business Master File – Address Change Procedures

Recommendation

The business address shown on the IRS Business Master File (BMF) should be static and be changed only by specific written request. Further, the structure of the BMF

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should be changed to allow multiple addresses for one company based on departmental functions.

Discussion

Currently the business address shown on the IRS BMF is changed every time a return is filed. Since most companies file multiple types of returns with the IRS on a regular basis, the address on the BMF is being changed every time. This presents a major problem to businesses that use different mailing addresses for each department that files a particular form for the company. For example, the payroll department that files Forms 941, 940, etc. quarterly and the annual Form W-2 has one address. The department that files the annual corporate tax return Form 1120 may have a different address. Still another department may handle the filing of information return Forms 1096 Annual Summary and Transmittal of U.S. Information Returns, 1099, Certain Information Returns, etc. using yet a different address depending on where that department is located. Since the IRS sends its correspondence to the last address shown on the BMF, notices are being sent to the wrong department on a regular basis thereby causing undue delay in correspondence getting to the proper person in the company.

Further it has been discovered that the BMF is being updated any time the IRS receives any "clear and concise written correspondence." As an example, an individual who had an account at a large bank wrote a letter to the IRS referring to the bank's corporate name and EIN. Based on the address shown on the correspondence, the IRS changed the corporation's mailing address on the BMF to the individual's mailing address. As a result of this erroneous change of address, all of the bank's mail was then sent to the individual account holder. This is an obvious example of a serious problem with the breach of privacy and confidentiality laws as well as causing an undue delay in actually getting the IRS notices concerning the corporation to the correct address for the corporation.

The problem lies with IRS Revenue Procedure 2010-16. This procedure states in part, that "the address shown on ANY form of written correspondence received by the IRS updates the address on the BMF." The Burden Reduction sub-group had a discussion with IRS personnel from the Service Centers. It was determined that there is inconsistent treatment of the address updates in the pipe line process.

Some of the more experienced employees that are aware of the problem, have by-passed the system requirements to update BMF address by only updating an address when a specific box is checked as applicable on various forms received. While still others are changing the address every time a return is filed as required by the Revenue Procedure cited above. We were told by IRS Service Center personnel that there have 12 projects trying to deal with this issue since 2008 and that there is still no clear resolution.

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We reviewed the draft version of Form 8822-B, Change of Address – Business, to be released to the public on January 1, 2012. This form allows for a mailing address and a business location address. However, it does not allow for multiple mailing addresses based on department function.

In its October 2010 report, IRPAC recommended some of these same changes to be made. The way this process is being handled, it could lead to privacy issues.

This issue was also discussed with Nina Olson and her associates with the National Taxpayer Advocate's Office. Their office is finding that taxpayers are not receiving their mail timely or sometimes not at all due to this BMF address problem. They have named this as one of their "Critical Issues" for 2011.

We believe that the current BMF system is structurally inadequate for the task. There simply are not enough fields to report multiple address for one corporation based on departmental functions.

**INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE**

**EMERGING COMPLIANCE ISSUES
SUBGROUP REPORT**

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Emerging Compliance Issues Subgroup

A. IRC § 6050W and Form 1099-K Reporting

Recommendations

On September 9, 2011, the IRS released a new draft of Form 1099-K, Merchant Card and Third Party Network Payments. This version of the form requires payment settlement entities to provide a Merchant Category Code (MCC) for each participating payee. IRPAC is troubled by this late draft which contains a significant modification. Due to the lateness of the current draft form IRPAC recommends that reporting on Form 1099-K be optional for payment card transactions that occur in 2011. Delayed reporting is warranted because:

1. Not all payment settlement entities use the MCC system. The MCC system is almost if not exclusive to Visa and MasterCard but not used by all types of PSEs (payment settlement entities).
2. Only one code is used per merchant. Very large vendors may have multiple MCCs the form is asking for the primary code (see Pub 1220, Specifications for Filing Forms 1097-BTC, 1098, 1099, 3921, 3922, 5498, 8935, and W-2G Electronically, Form 1099-K beginning on Pg 291).
3. The MCC system is merchant specific and not transaction related so transactions should not be compared to MCC.
4. The code may exist but not all have access to the code (non-VISA & MasterCard, third party network organizations etc.)
5. Adding the MCC is a significant form change that is too late to be implemented into the current technology being used to produce Form 1099-K.

In addition to the issues highlighted by the late draft form outlined above, IRPAC makes a number of additional recommendations related to IRC § 6050W and Form 1099-K. Most of the recommendations relate to the need for additional guidance. These recommendations are set forth below as numbered items.

1. IRPAC recommends that the IRS provide additional official guidance (e.g., revenue rulings, notices, revised regulations) to further address open questions regarding IRC § 6050W. Official guidance is necessary to address open questions regarding the meaning and scope of the terms in the statute and Treasury Regulations.
2. IRPAC urges Treasury and the IRS to make reporting on Form 1099-K optional for 2011. Due to the substantial open and unresolved questions not yet addressed by the IRS regarding the scope and application of the law and, as a consequence, the lack of sufficient time for reporting organizations to

Emerging Compliance Issues Subgroup

establish systems and controls to comply, implementation of reporting under IRC § 6050W for 2011 should not be required until at least 2012 or later, depending upon when the IRS's issues essential guidance in a format that can reasonably be relied upon (e.g., regulations, notices, revenue rulings) by those responsible for investing substantial financial resources in the systems necessary to carry out these rules. Late changes are also evidently being made to the draft 2011 Form 1099-K related to MCCs. It is not possible for reporting organizations to report data that they have not previously been instructed to collect and compile, particularly not at the end of the reporting year. Moreover, as we explained in our 2011-2012 Guidance Plan IRPAC Comment Letter ([See Appendix A](#)), programming changes take many months for reporting organizations to effectuate, and the IRS needs to build additional time into the process to allow reporting organizations to collect information and make necessary changes. Thus, with the tremendous uncertainty and upheaval related to the 2011 Form 1099-K and related uncertainty regarding the rules, IRPAC strongly recommends that 1099-K reporting be made optional for 2011.

3. Key terms integral to the meaning of “third party payment network” must be defined in official guidance in order for reporting organizations to reasonably apply the rules. These terms include “central organization,” “guarantee,” and “substantial number of providers of goods or services.” IRPAC’s detailed recommendations related to the definition of these terms can be found in its March 28, 2011, comment letter in Appendix D.
4. The definition of “third party payment network” can be interpreted broadly to include transactions not apparently considered by Congress when it drafted the statute. Guidance should be issued to clearly set forth the IRS’s understanding of the scope of the statutory and regulatory language to various arrangements that involve three parties but may not constitute a “third party payment network.” For example, guidance should address whether certain common three-party arrangements involving the transfer of accounts receivable constitute third party payment networks for purposes of Form 1099-K reporting.
5. IRPAC believes that certain three party transactions should remain reportable under IRC § 6041. These include transactions in which payments are made on behalf of another person under Treas. Reg. § 1.6041-1(e), such as arrangements involving certain self-funded health plans and accounts payable processing arrangements (both related-party shared-services arrangements and third-party total-outsourcing arrangements). The final IRC § 6050W regulations provide that in all instances in which transactions are otherwise subject to reporting under both IRC § 6041 and IRC § 6050W, the transaction must be reported under IRC § 6050W and not IRC § 6041. IRPAC

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- recommends that Treasury and the IRS grant certain limited exceptions to this rule. See IRPAC's March 28, 2011, comment letter in Appendix D.
6. Guidance is necessary to address how the transaction-based reporting approach applicable in the payment card context applies to arrangements involving third party payment networks. The narrow scenarios applicable in the payment card context are not easily or readily applied to the varying scenarios that can arise in the context of third party network transactions. Guidance is needed to address reporting in this area, particularly in cases such as payments for medical services where amounts invoiced by physicians often bear little, if any, relationship to the amounts ultimately received in satisfaction of the invoice.
 7. The documentation requirements for U.S. payers to foreign merchants should be relaxed to conform to the requirements for non-U.S. payers.¹
 8. Additional time to report on Form 1099-K should be permitted for the deemed participating payee under aggregated payee arrangements because the date on which reporting is required by the deemed participating payee to related aggregated payees is the same date as the date on which the Form 1099-K is due to the deemed participating payee from the payment settlement entity.
 9. Guidance is needed to identify the entity deemed to be the payment settlement entity when there are multiple payment settlement entities. There is tension between the language of the preamble under "payment settlement entity" and the language in Treas. Reg. § 1.6050W-1(a)(4)(ii). In particular, the last sentence of the second paragraph of the preamble provides, "[t]he final regulations clarify that the entity that makes a payment in settlement of a reportable payment transaction is the entity that actually submits the instruction to transfer funds to the account of the participating payee to settle the reportable payment transaction" whereas Treas. Reg. § 1.6050W-1(a)(4)(ii) provides "[i]f two or more persons qualify as payment settlement entities . . . with respect to a reportable payment transaction, then only the payment settlement entity that in fact makes payment in settlement of the reportable payment transaction must file the information return required by paragraph (a)(1) of this section." Stated differently, the preamble emphasizes "submitting the instruction to transfer funds" while the actual regulation emphasizes "in fact makes payment." This has caused confusion in certain

¹ Some relief has been provided regarding the documentation required to be obtained by U.S. payers from foreign merchants under Treas. Reg. § 1.6050W-1(a)(5). See IRS Notice 2011-71; 2011-37 IRB 1. This relief will require U.S. payers to search their business records for indicia of U.S. status for accounts with non-U.S. addresses. The Notice, while providing relief, imposes a significant due diligence requirement with only four months remaining in the reporting year.

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arrangements in which the instruction to transfer funds and the actual transfer of the funds are performed by separate entities.

10. Guidance is needed to clarify whether an electronic payment facilitator can also be a payment settlement entity. Clarification is necessary because questions regarding which party is liable for reporting failures are arising when electronic payment facilitators are involved in processing transactions. There seems to be overlap related to the rules regarding multiple payment settlement entities and electronic payment facilitators. Clarification regarding how these roles interact is necessary to address questions of liability related to proper reporting of transactions.
11. The final regulations contain an address rule for U.S. payers with pre-existing contracts with participating payees with non-U.S. addresses. The regulations permit a payment settlement entity that is a U.S. payer to treat accounts as non-U.S. (not subject to reporting or withholding) if a contract was entered into on or before December 31, 2010. As a result, U.S. payers and non-U.S. payers are not required to obtain proof of the account's non-U.S. status (Forms W-8BEN, Beneficial Owner's Certificate of Foreign Status for U.S. Tax Withholding, etc.). The regulations require U.S. payers to obtain proof of the account's non-U.S. status if there is a material modification to the contract. A mere renewal is not considered a material modification. Many payment settlement entities frequently renew or modify the terms of payment card arrangements. For example, the interest rate or the frequency of payment can change several times in a year. IRPAC recommends that the IRS provide guidance related to what constitutes a material modification. This guidance should provide a definition of the term "material modification," together with illustrative examples.

Discussion

IRC § 6050W and the related Treasury Regulations require the reporting of two significant classes of transactions, payment card transactions and third party network transactions, on newly created Form 1099-K. Payment card transactions are any transactions in which a payment card (or any account number or other indicia associated with a payment card) is accepted as payment. Payment cards include credit cards and stored value cards, which are cards with a prepaid value including gift cards. Third party network transactions are any transactions settled through a third party payment network. A third party payment network is any agreement or arrangement that (a) involves the establishment of accounts with a central organization by a substantial number of providers of goods or services who are unrelated to the organization and who have agreed to settle transactions for the provision of the goods or services to purchasers according to the terms of the agreement or arrangement; (b) provides standards and mechanisms for settling the transactions; and (c) guarantees payment to

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the persons providing goods or services in settlement of transactions with purchasers pursuant to the agreement or arrangement.

Final Treasury Regulations under section 6050W were issued on August 16, 2010, and the reporting rules became effective on January 1, 2011. See T.D. 9246. Backup withholding in connection with transactions under IRC § 6050W becomes effective on January 1, 2012. In contrast to information reporting returns that have existed for many years (*e.g.*, Forms 1099-MISC, Miscellaneous Income etc.), the Form 1099-K requires a monthly breakdown of the amounts required to be reported and the reported amounts seem to be based upon a transactional approach rather than upon actual payments.

The transition to reporting rules under IRC § 6050W is an exceptionally challenging one for both the IRS and reporting organizations. The drafters of the Treasury Regulations had to address an overwhelming number of challenging policy and drafting issues, including very broad statutory language regarding third party networks. IRPAC believes that the drafters at IRS and Treasury did a commendable job in discharging their responsibilities and developing a foundation from which IRC § 6050W reporting can ultimately be launched. Nevertheless, IRPAC believes that additional guidance is urgently needed before the rules under IRC § 6050W become mandatory for reporting organizations. It cannot be emphasized enough that reporting under IRC § 6050W constitutes a sea change for reporting organizations, and many reporting organizations are not only struggling to understand the rules as written, but whether they are even subject to the rules in the first place. Accordingly, IRPAC urges Treasury and the IRS to make reporting under IRC § 6050W optional for 2011 and to issue additional formal guidance as soon as possible in order to facilitate a smooth transition to IRC § 6050W reporting.

A critical element to any successful information reporting system and effective tax administration is clarity -- clarity with respect to the scope of transactions for which reporting is required, clarity as to who is required to report, and clarity regarding the information and data that must be reported. Without clear rules, reporting organizations cannot implement necessary controls and procedures -- which in today's business environment involve the use of expensive computer systems and even more expensive enterprise software -- to effectuate the information reporting returns required by the government. Unfortunately, despite the ongoing work of the IRS and IRPAC, there remain significant components of the 1099-K reporting rules that lack this level of clarity.² And, with more than eight months following the effective date of the regulations, little has been accomplished to remove the confusion and uncertainty related to these rules and the reporting form has not been finalized. Accordingly, IRPAC strongly believes that the IRS must act quickly to address these concerns and provide

² See Treasury Inspector General for Tax Administration's Report of July 26, 2011, entitled Plans for the Implementation of Merchant Card Reporting Could Result in Burden for Taxpayers and Problems for the Internal Revenue Service, Ref. No. 2011-40-065.

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the needed clarifications and implementation lead-time, starting with making the 2011 reporting optional and providing good faith transitional relief for reporting penalties.

B. Information Regarding IRC § 3402(t) 3% Withholding

IRC § 3402(t)(1) provides that the Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies) making any payment to any person providing any property or services (including any payment made in connection with a government voucher or certificate program which functions as a payment for property or services) shall deduct and withhold from such payment a tax in an amount equal to 3% of such payment.

Recommendations

IRPAC supports the decision in IRS Notice 2010-91 to not apply withholding and related reporting requirements under IRC § 3402(t) to payments made by payment card until further guidance is issued. Prior to issuance of such guidance, IRPAC recommends a public comment period and hearing for proposed regulations on the issue of payment card reporting.

IRPAC recommends exclusion from withholding under IRC § 3402(t) for contractual arrangements where service providers manage financial operations and remit a payment net of fees for services to government entities as no payment is made by a government entity in these situations. In many of these arrangements service providers would remit the withholding amount to the government entity to be deposited with the IRS and would provide the government entity with the related income amount to be reported to the IRS. Application of IRC § 3402(t) withholding rules to these contractual arrangements is impractical.

IRPAC recommends clarification that payments for medical services made by insurance companies that provide administrative services for a self-funded health plan or a non-insurance third party administrator that performs substantially the same services are not subject to withholding under IRC §3402(t).

IRPAC recommends a withholding exemption that allows a proportionate pass through of an exemption to government and tax-exempt entities that have an ownership interest in a service provider that fails to meet the 80% ownership test. If this cannot be devised, then there will need to be a rapid relief refund process developed that will appropriately re-divert withheld funds back to a project where it was intended to be deployed.

Implementation of withholding under IRC § 3402(t) will require significant additional resources from governmental information technology (IT) departments. The IT market has not produced a nationwide software package leaving governmental entities to create their own. Accordingly, IRPAC requests that the good faith exception

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in Treasury Regulation § 31.3402(t)-7 be extended until after calendar year 2015 and, in addition to waiving interest and penalties, waive the withholding requirement if the government entity can establish in good faith its inability to comply due to IT limitations.

Discussion

IRC § 3402(t) of the Code was added by section 511 of the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109-222 (TIPRA), 120 Stat. 345, which was enacted into law on May 17, 2006. IRC § 3402(t)(1) provides that the Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies) making any payment to any person providing any property or services (including any payment made in connection with a government voucher or certificate program which functions as a payment for property or services) shall deduct and withhold from such payment a tax in an amount equal to 3 percent of such payment. IRC § 3402(t)(2) provides exceptions to withholding under IRC § 3402(t).

Proposed regulations under IRC § 3402(t) of the Code were published in the Federal Register on December 5, 2008. After the issuance of the proposed regulations, section 1511 of the American Recovery and Reinvestment Act of 2009, Public Law 111-5 (ARRA), 123 Stat. 115, 355, extended the effective date of section 3402(t) withholding to payments made after December 31, 2011. Notice 2010-91, 2010-52 IRB 915, provided interim guidance on the application of IRC § 3402(t) to payments by debit cards, credit cards, stored value cards, and other payment cards.

Final regulations under IRC § 3402(t) of the Code were filed with the Federal Register on May 6, 2011 providing an additional one-year extension from the revised statutory effective date of payments made after December 31, 2011. Thus, under final regulations, IRC § 3402(t) withholding and reporting requirements apply to payments made after December 31, 2012, subject to an exception for payments made under contracts existing on December 31, 2012, that are not materially modified (proposed regulations issued at the same time as the final regulations provide that the exception for payments made under existing contracts will not apply to payments made on or after January 1, 2014).

C. Central Withholding Agreements: Addressing Needs of Venues and Foreign Artists Through a Mini-CWA Program and Problems Encountered by Foreign Artists when Applying for U.S. Social Security Numbers (SSNs).

Recommendations

In 2010 IRPAC made the following recommendations in our public report:

1. A smaller version of the Central Withholding Agreement (CWA) is needed to support single and limited venues. IRPAC recommends that the IRS develop

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a mini-CWA program that would apply to performers with annualized fees of \$50,000 or lower. The program should allow the performer to apply directly for a lower withholding rate or a waiver from withholding based on disclosed fees and known expenses.

2. Allow the CWA Program to issue Individual Taxpayer Identification Numbers (ITINs) to performers who have applied for relief in the CWA Program so that the agreement can be finalized where the SSN has not yet been acquired or a denial letter received.

In 2011, IRPAC has worked diligently with representatives of LB&I in their efforts to develop a mini-CWA process, and to address the missing SSN/ITIN concern.

Discussion

The IRS response to these recommendations has been very positive. In 2011, IRPAC worked with the IRS on the structure of a new simplified CWA for entertainers, which will ultimately become part of a revenue procedure currently being revised. The mini-CWA changes outlined above would require a change to Revenue Procedure 89-47 and is currently under review and discussion with the Office of Chief Counsel, International. However, there is no designated target date for its completion. The proposed structure is to provide for three levels of the new CWA program:

- Gross Receipts of \$20,000 or less where you can request a CWA and no reporting agent needed,
- Gross Receipt totals \$50,000 for the year, where a similar application would be allowed, but the entertainer would have to submit a budget, and
- Gross Receipts over \$50,000 where the entertainer will need a reporting agent.

IRPAC will continue to support this endeavor.

The remaining issue is the challenge a Foreign Artist has receiving either an SSN or an ITIN depending upon the action of the Social Security Administration (SSA) in a timely manner to allow the CWA to be finalized. Individual artists frequently encounter problems in applying for SSNs while they are here in the U.S. The problems performers face include:

- Artists apply for SSNs but never receive a number OR receive a rejection letter from SSA;
- Personnel at SSA offices around the country sometimes do not allow individual artists to apply for numbers on the basis that the artist is not

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eligible. This may result from the fact that the artist is in the country for too few days to qualify, or for other – erroneous – reasons, such as lack of work authorization, even when the artist IS work authorized;

- Sometimes artists are booked so tightly during their U.S. tour that it simply is not possible for them to get into a SSA office to apply for a SSN.

IRPAC understands that the CWA Program frequently runs into this concern and the final agreement is held up until an SSN is assigned or the rejection letter received that allows for an ITIN to be issued. Ideally, if an ITIN or an SSN as applicable were easier to obtain, these problems could be alleviated. Except for the cases involving scholarships and certain honorariums paid in academics, a nonresident would have to get a SSN rejection letter from SSA in order to apply for an ITIN. The reject letter would need to be attached to the W-7, Application for IRS Individual Taxpayer Identification Number, in order for the IRS to proceed. Currently, the SSA is inconsistent in its approach to the SSN application process and the IRS has indicated its hands are tied. IRPAC will continue to work toward a solution.

At the SSA in Las Vegas, a foreign artist can apply for an SSN and they will mail a reject letter. If you apply for an SSN at the SSA Denver Office, the office mandates that applicants appear in person to receive the denial letter after 21 days have passed. It was noted that an applicant must wait 10 days in the U.S. before they can apply for an SSN, and another 21 days before they can pick up the denial letter, collectively the 30+ day stay may go beyond many I-94 stay periods (usually 30 days or less) and the whole process becomes impossible for the artist. In these cases, the use of the CWA process is blocked until the SSN/ITIN matter is resolved. The subcommittee asked whether the IRS has discretion to remove the requirement of the SSN denial letter from the ITIN application process in these cases and was informed for many reasons that it could not be done.

D. Withholding and Reporting on Payments for Freight, Shipping, and Other Transportation Expenses under IRC § 1441 and 1442 Recommendations

The following recommendations are included to supplement the recommendations included in pages 12 and 61-68 related to this issue in the 2010 IRPAC Report. A more abbreviated synopsis of this issue, however, is included in the discussion section below:

1. The Form W-8BEN, Beneficial Owner's Certificate of Foreign Status for U.S. Tax Withholding should be revised to allow foreign corporations engaging in international shipping or air transportation to identify that they are either subject to the excise tax under IRC § 887(a) or qualify for the exclusions described under IRC §§ 883(a)(1) or (2) and Treas. Reg. § 1.883-1. Specifically, Part III of the Form W-8BEN should be retitled "Miscellaneous" and include a line 12 providing a check box with the following language: "The

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- above identified corporation, whose U.S. taxpayer identification number is stated on line 6, is either (a) subject to the 4% excise tax for U.S. Gross Transportation Income ("USGTI") or (b) qualifies for the exclusion of income from the international operation of ships or aircraft provided under IRC § 883(a)(1) or (2)."
2. Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, should be revised to add a specific income code for U.S. source income from international shipping or air transportation.
 3. The current description of this issue within Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities, should be revised to reflect these changes and discussion of the law herein.

Discussion

The interplay of IRC §§ 871, 881, 882, 883, and 887 are confusing as they relate to the taxation of USGTI and international transportation provided by ship or aircraft. Accordingly, we provide herein a brief recap of the salient statutory provisions regarding USGTI and a foreign corporation's eligibility for exemption from withholding for transportation by ship or aircraft under IRC §§ 1441 and 1442.

IRC §§ 1441 et seq. provide the mechanism for withholding and reporting items of income subject to the gross-basis tax set forth in IRC §§ 871 and 881. In general, a 30% withholding tax is imposed on the U.S. source fixed and determinable annual or periodical (FDAP) income of a nonresident alien individual or foreign corporation. FDAP income is broadly defined and includes income from the performance of services. Income from ship and air transportation and income from transportation over road or rail are services included within the meaning of FDAP income.

IRC § 887(a) imposes a 4% excise tax on USGTI.³ This 4% excise tax is self assessed by a foreign corporation that engages in shipping or air transportation. USGTI includes income from the international operation of ships and aircraft by foreign corporations. IRC § 887(a)(1); IRC § 883(a)(1) and (2). When the 4% excise tax imposed on USGTI applies, the gross-basis withholding tax imposed under IRC §§ 871 and 881 and carried out through IRC §§ 1441 and 1442 does not apply. Conversely, when the 4% excise tax under IRC § 887(a) does not apply, the ship or air transportation income of a foreign corporation is subject to 30% withholding under IRC §§ 881, 1441 and 1442.

An exclusion from income from the international operation of ships or aircraft is also provided under IRC § 883(a)(1) and (2) and Treas. Reg. § 1.883-1. In general this

³ There are various statutory exceptions for USGTI under IRC § 887, but a discussion of these exceptions is not necessary for the purpose of addressing the documentation that withholding agents should be required to obtain or may need to obtain for purposes of establishing that withholding is not required under IRC § 1441 or 1442.

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exclusion applies for qualifying income derived by a qualified foreign corporation from its international operation of ships or aircraft only if the foreign country grants an equivalent exemption from taxation for the international operation of ships or aircraft by corporations organized in the United States. IRC § 883(a)(1) and (2); Treas. Reg. § 1.883-1(h). This exclusion from gross income applies for purposes of both USGTI taxed under the 4% excise tax of IRC § 887(a) and the 30% withholding tax under IRC §§ 882, 1441, and 1442.⁴ Thus, the critical issues to be addressed by the IRS are as follows:

1. What documentation does a withholding agent need to obtain from a foreign corporation engaged in international transportation by ship or aircraft in order to establish that withholding under IRC §§ 1441 and 1442 does not apply?
2. What income code should be used to report U.S. source income to a foreign corporation engaged in international transportation by ship or aircraft on Form 1042-S?

IRPAC believes that this issue is easily resolved by a modest change to the Form W-8BEN, and the IRS should act as soon as possible to address this issue. Further, the burden on withholding agents need not be complicated. IRPAC recommends that withholding agents should only be required to obtain a properly completed and executed Form W-8ECI, Foreign Person's Claim of Income Effectively Connected with the Conduct of a Trade or Business in US, or Form W-8BEN to establish that no withholding is required under IRC §§ 1441 and 1442. The Form W-8ECI is currently functional for this purpose because it establishes that the beneficial owner has effectively connected income and is subject to U.S. tax, but the Form W-8BEN is not functional in its current form. Accordingly, the Form W-8BEN must be revised to allow foreign corporations engaging in international shipping or air transportation to identify that they are either subject to the excise tax under IRC § 887(a) or qualify for the exclusions described under IRC §§ 883(a)(1) or (2) and Treas. Reg. § 1.883-1.

A change to the Form W-8BEN does not need to be significant to address this issue. IRPAC recommends that the IRS retitle Part III of the Form W-8BEN "Miscellaneous" and add a line 12 that provides a check box with the following language: "The above identified corporation, whose U.S. taxpayer identification number is stated on line 6, is either (a) subject to the 4% excise tax for U.S. Gross Transportation Income or (b) qualifies for the exclusion from income for the international operation of ships or aircraft provided under IRC § 883(a)(1) or (2)." By taking this simple approach, the IRS will enable withholding agents to clearly determine whether

⁴ See Private Letter Ruling 8917052 (Jan. 31, 1989) ("[i]f a foreign corporation is eligible for benefits under section 883(a)(2), its gross income from the international operation of aircraft will be excluded from gross income for U.S. tax purposes and it will be exempt from tax under sections 882(a) and 884 or under section 887").

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they need to withhold on payments of US-source income to foreign vendors that engage in transportation by ship or aircraft.

With respect to the reporting of payments of transportation income by ship or aircraft, IRPAC recommends that the IRS identify a specific income code on Form 1042-S for such income. Further, the current description of this issue within Publication 515 should be revised to clarify this issue, as the current language is insufficient and may be misleading.

E. Information Regarding Form 1098-T Reporting of VA/GI Bill Benefits

IRPAC requested clarification in Form 1098-T, Tuition Statement, instructions regarding proper reporting of VA/GI bill benefits and supports IRS plans to revise the 2012 instructions for Form 1098-T.

Recommendations

IRPAC recommends that the IRS revise the 2012 instructions for Form 1098-T in order to clarify that VA/GI bill benefits should be reported as a scholarship/grant in box 5 of the Form 1098-T.

Discussion

There has been widespread confusion and a lack of clarity in the higher education community about how VA/GI bill benefits should be reported on the Form 1098-T. The enabling statute, 20 USC §1087v v, specifies that for purposes of awarded student financial aid, VA benefits should not be considered as income or a scholarship to the recipient. Many institutions have interpreted this to mean that they must not include VA benefits in box 5 of the 1098-T (where grants, scholarships, and tuition reduction amounts are to appear).

IRS Publication 970, Tax Benefits for Education, indirectly addresses the issue as it instructs taxpayers that amounts of GI bill benefits earmarked for tuition and fees received do not count as qualified payments against the federal education tax credits, therefore for tax purposes treating the VA benefits as scholarships, grant aid, and tuition reductions.

For student aid purposes, institutions cannot include the amount of VA tuition benefits as a resource in their calculation of need; however, for tax reporting purposes those amounts should be reported in box 5 of the Form 1098-T, in addition to any other grants, scholarships, or tuition reductions administered by the institution (amounts that generally may not be claimed against the credit).

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F. Information Regarding Non-Resident Alien Taxation and Tax Reporting Recommendations

Over the last two years, IRPAC has recommended that the IRS publish information as web based content on irs.gov to assist taxpayers in the following areas of nonresident alien taxation and reporting:

- Tax residency rules
- Income tax rules
- Withholding tax rules (including employment tax)
- Tax treaty rules
- Special tax information for alien categories

In response, the IRS LB&I Operating Division worked with IRPAC to develop extensive web-based content in a new section titled “Taxation of Aliens by Visa Type and Immigration Status”. IRPAC made the following recommendations in the context of clarifying a withholding agent's responsibilities in using this information:

- IRPAC suggested IRS adopt a few paragraphs for the landing page specifically regarding payer responsibilities that focus on the receipt of forms in the W-8 series and Form 8233, Exemption from Withholding on Compensation for Independent (& Certain Dependent) Personal Service of a Nonresident Alien Individual, which would clarify a payer’s due diligence requirements. IRPAC stressed the key to the landing page is focusing on the payers accountability.
- IRPAC noted when the payer cannot determine tax residency the payer needs to understand the reason to doubt rules based on the information they received on the certification.

Discussion

For the most part, payers are allowed to rely on payee representations made on a Form W-9 if the payee is a U.S. citizen or tax resident, or representations from a non-resident payee made on one of the forms in the W-8 series (or in cases of treaty claims for personal services made on Form 8233 once filed with the IRS and the appropriate waiting period met without IRS denial of the application). These forms serve as the basis for determining whether the payee is to receive Forms 1099 or is covered under the rules for withholding at source under IRC §1441 and Form 1042 -S reporting. Payees have the burden to inform payers of any changes in status and pursuant to certification instructions have 30 days from the event to notify payers of any changes by providing new forms.

Where there is actual knowledge or reason to know that information on a submitted certification, such as a Form W-8BEN or Form 8233 is incorrect, reliance placed on the certification is lost. Where treaty claims on Forms W-8BEN or 8233 are

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submitted to payers, the claims need to be reviewed and confirmed that the treaty rate claimed is correct and treaty terms are satisfied to the best of a payer's knowledge. (See Reg. §§1.1441-1(e)(2)(ii), -1(e)(4)(viii), -6(b), -7(b)). The details in the newly proposed web pages provide a level of knowledge to enable a payer to perform the due diligence required by these provisions. The landing page proposed by IRPAC is intended to explain these payers' responsibilities in the use of the provided materials.

Currently, the landing page has two sections, withholding requirements and a discussion of tax residency rules, but fails to address the payer's responsibilities regarding receipt of related certifications. The IRS is willing to create a separate page to accommodate the suggested information and provide a link to a much shorter version of the IRPAC suggested cover page to which IRPAC agreed. The work on the NRA Website that the IRS has done is very complex. It will include immigration law, income tax rules, withholding tax rules, and tax treaties. The landing page will have 25 links to 25 different visas. The subheading will have different categories, i.e., green card, refugees, etc. The taxpayer would click on information and be directed to five different options, residency, tax treaty, etc. Completed pages have been submitted by LB&I for approval by Counsel and to various branches. The approval process is lengthy and it will be awhile before the material is actually posted on the IRS website. IRPAC and the IRS will continue to work on this project in 2012.

G. Identity Theft and Information Reporting Recommendations

IRPAC has previously recommended and continues to recommend that the IRS provide clear guidance on whether or not Forms 1099 should be filed with the IRS and recipient copies furnished to the named payees of fraudulent accounts. IRPAC recommends that the IRS reconsider the potential burdens to the victims of identity theft when forms are issued to them as well as when forms are not issued to them. IRPAC also recommends that the IRS reconsider the confusion existing in the payer community by the current situation. Assuming that clarifications can be made to the current requirement for the continued issuance of Forms 1099 to identity theft victims, IRPAC requests that the IRS consider the potential burdens on payers by such clarifications, particularly if they would require system modifications.

Discussion

Sometime in early to mid 2009, IRPAC became aware of situations where payments were being made to accounts that were fraudulently opened with the name and social security number of an identity theft victim. In cases where the payer has knowledge before the Form 1099 filing deadline that payments were made to a fraudulent account, there is a lack of clarity as to whether a Form 1099 should be issued to the identity theft victim for that account. The current rules and regulations do not provide clear guidance on what a payer should do in cases of identity theft. IRPAC met twice this year with IRS staff from W&I to discuss whether or not reporting could be

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addressed more clearly in these situations in order to eliminate meaningless reporting to the IRS and the identity theft victim and minimize the burden on the payer community. IRPAC has explained that if Forms 1099 were issued in the name and social security number of the identity theft victim, the IRS would expect the payments to be reported on the identity theft victim's Form 1040. The victim might not include the payment amounts on his or her return either because (s)he knows that the income did not belong to her/him or (s)he is unaware of the identity theft (where, for example, the form was not sent to the victim's current address). This may result in the IRS sending unreported income notices to the victim and following through on its normal processes that are likely to be burdensome on the victim and the IRS without any benefit to the government.

IRPAC has made specific suggestions for handling information reporting in situations involving identity theft. Specifically, IRPAC has requested that the IRS provide something specific in the instructions to Forms 1099 to eliminate the need for such reporting to the victim in a situation involving known identity theft. IRPAC noted that the current instructions to Form 1099-C, Cancellation of Debt, indicate that the form should not be issued in a known identity theft situation and suggested expanding this instruction to other Forms 1099. Alternatively, IRPAC suggested that, in known identity theft situations, Forms 1099 could be issued to "unknown payee." IRPAC noted that reporting to "unknown payee" is permitted in the case of Form 1042-S reporting under Treas. Reg. § 1.1461-1(c)(4)(ii). Permitting similar reporting on Form 1099 in identity theft situations would allow the payer to comply with the requirement to issue the forms and also to reconcile any backup withholding, but would also not result in the IRS generating a B Notice or penalty notice.

IRPAC understands from meetings with the IRS that it views the current instructions for Form 1099-C eliminating the reporting requirement in the case of identity theft as unique to the debt forgiveness situation since, in that case, there was no debt owed by the victim to be forgiven. When payments are made or credited to fraudulent accounts, the IRS characterizes the payments as actually having been made or credited to the account of the identity theft victim, who presumably could have accessed those payments.

However, in fact, the victim was not aware of the existence of the fraudulent account and, therefore, although it was theoretically possible that the victim could have accessed the payments, it was a realistic impossibility. Moreover, legally, it is unclear whether the theft victim even has an ownership interest in the property that would allow such access. The IRS asserts that it has no authority to add anything to the instructions to Forms 1099 because the payments were actually made or credited to some taxpayer. IRPAC agrees that the payments were made to someone, *i.e.*, the identity thief, but the identity of the thief is unknown to the payer. Consequently, permitting the payer to report to "unknown payee" not only accurately characterizes the payment recipient, it also eliminates meaningless reporting to both the IRS and the identity theft victim and minimizes the burden on the payer community.

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With respect to the suggestion of reporting to “unknown recipient,” the IRS contends that it has no authority to permit such reporting unless it is authorized in the Regulations. Consequently, the IRS suggested to IRPAC that the solution to eliminating reporting on Form 1099 with respect to identity theft accounts would be a change in the regulations to allow for reporting to “unknown payee,” similar to what is permitted in the regulations under IRC §1441. The IRS also suggested that IRPAC reconnect with the IRS Identity Protection Specialized Unit for support of this undertaking.

H. Changes to Pub. 3908, Gaming Tax Law and Bank Secrecy Act Issues for Indian Tribal Governments

Recommendations

IRPAC drafted paragraphs to replace last paragraph on page 27 and top paragraph of page 28, IRS Publication 3908, to answer: How do you verify if the winner is a nonresident alien subject to Form 1042-S reporting and withholding at 30%? In the draft, IRPAC covered:

- Why W-8BENs are needed
- How and when they should be completed by the non-resident
- Withholding and 1042-S reporting instructions on receipt of the W-8BEN
- Some discussion on legal documentation presented by the winner and the conflicts they present for tax purposes

Discussion

It was brought to the attention of IRPAC by LB&I that gaming operations were experiencing a high incidence of misfiled Forms 1042-S. Many were being filed without proper permanent foreign addresses and with other concerns. In exploring causes, IRPAC further learned that operators were having a difficult time identifying non-resident alien (NRA) winners for withholding purposes, much less the details they need for Form 1042-S completion.

IRS Publication 3908 provides Indian gaming operations with the latest tax law and Bank Secrecy Act information (Title 31) applicable to gaming operations for gaming activities and is widely followed by gaming operators around the country. Upon review of Publication 3908, IRPAC discovered that although the publication did address the Title 31 standards for foreign players, it did not address the use of Form W-8BEN as a source for identifying NRAs. Form W-8BEN requires a permanent foreign address and other information that can be used for 1042-S filing purposes. Receipt of this form from NRA winners would result in better identifying NRAs and have the end result of improving the integrity of the 1042-S forms filed.

Usually gaming winners, who are NRAs, are visitors from other countries or temporarily residing on a short term basis in the U.S. Identifying NRAs can be difficult

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even where payers have a long-term payment relationship, but where they are gaming winners little is comparatively known about the individuals in the very short period of time they are playing in the facility. In some cases, the winner might not even have a passport, such as a Canadian tourist who may only have his or her Canadian driver's license. A driver's license works for Title 31, but not for making the tax status determination. To add to the confusion, many U.S. tax residents carry government documentation that even contain the word "alien", but such documentation has no bearing on the individual's true U.S. tax status. For an example of the struggles gaming houses are experiencing, see *Sang J. Park v. Commissioner.*, U.S. Tax Court, 136 T.C. No. 28, (Jun. 13, 2011) where an NRA with an L-1 visa status provided a tribal gaming house with fraudulent tax certifications. Absent clear guidance, it is very difficult for gaming operators to know when 30% withholding and Form 1042-S reporting is required.

The ECI Subgroup offered language to the Service (TEGE and LB&I) and to Indian Tribal Governments (ITG) to enhance Publication 3908 and to assist gaming operations in correctly NRA winners for withholding and reporting purposes. The Service agreed to the changes based on the language submitted and ITG agreed to insert the revised language in Publication 3908 the next time the publication is revised. Meanwhile, ITG is addressing the concern in an article on the W-8 BEN in the next gaming newsletter and developing a supplement to the publication.

Emerging Compliance Issues Subgroup

**INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE**

**INTERNATIONAL REPORTING AND
WITHHOLDING
SUBGROUP REPORT**

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International Reporting & Withholding Subgroup

A. Foreign Account Tax Compliance Act

IRPAC has worked closely with the IRS and Treasury regarding the implementation of the Foreign Account Tax Compliance provisions of Subtitle A of Title V of the HIRE (Hiring Incentives to Restore Employment) Act (commonly referred to as FATCA). IRPAC has engaged in an ongoing dialogue with the IRS and Treasury regarding the guidance released by the IRS to date; specifically, Notices 2010-60, 2011-34, and 2011-53. IRPAC intends to continue this dialogue and provide input with regard to the Proposed Regulations that are expected to be issued by the end of 2011.

Following is a summary of the principal issues that have been discussed.

1. Short-term Debt

Recommendation

IRPAC recommends that interest (including original issue discount) on short-term debt (i.e., debt having a term of 183 days or less) be excluded from the definitions of “withholdable payment” and “financial account” under FATCA, consistent with the terms and policies implemented by the exemption for such amounts under Chapter 3.

Discussion

FATCA generally imposes withholding and information reporting obligations with respect to “withholdable payments.” The definition of “withholdable payment” includes U.S.-source interest (including original issue discount),¹ but does not provide an explicit exception for interest or original issue discount on short-term debt, unlike the comparable rule under Chapter 3.² Similarly, FATCA imposes reporting requirements with respect to “United States accounts,” which include any debt interest in a financial institution, other than interests that are regularly traded on an established securities market.³ The statutory provisions relating to United States accounts also provide no exclusion for short-term debt instruments.

A long-standing rule under Chapter 3 exempts interest and original issue discount on short-term debt from withholding tax. This exemption was enacted to preserve U.S. borrowers’ access to critical sources of funding.⁴ Although FATCA does not include a statutory exemption for short-term debt, Congress clearly recognized the policies served by the Chapter 3 exemption and suggested that Treasury and the IRS

¹ IRC §1473(1)(A)(i).

² See IRC §§ 871(a)(1)(C), 871(g)(1)(B)(i), 881(a)(3)(A). This exemption applies to debt having a term of 183 days or less.

³ See IRC §§ 1471(d)(1)(A), 1471(d)(2)(C).

⁴ See, e.g., “Foreign Investors Tax Act of 1966: Hearings on H.R. 13103 Before the Senate Committee on Finance,” 89th Cong., 2nd Sess. at 64-65, 70-71, 93-94 (1966); “Foreign Investors Tax Act of 1966; Presidential Election Campaign Fund Act; and Other Amendments,” Report of the Committee on Finance, United States Senate at 23-24 (1966); see also Shajnfeld, “Original Issue Discount and the Foreign Investor – More Uncertainty about United States Treasury Bills,” 36 Tax Law. 293, 307 (1983).

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consider adopting a short-term debt exemption under FATCA. The Joint Committee on Taxation's report on the HIRE Act includes the following language:

“The Secretary may determine that certain payments made with respect to short-term debt . . . pose little risk of United States tax evasion and may be excluded from withholdable payments for purposes of this provision.”⁵

The Joint Committee's report includes comparable language relating to a short-term debt exemption from the definition of “financial account” (which is a component of the definition of “United States account”).⁶

IRPAC believes that continued access to sources of short-term funding, including short-term interbank deposits, Treasury bills, commercial paper, and other similar financing arrangements, is critical to U.S. borrowers, in particular in the current economic environment. IRPAC is concerned that the imposition of FATCA's reporting and withholding requirements to these financing arrangements will impose undue burdens, in particular given the short-term nature of the transactions, and would risk reducing the availability of critical funding for U.S. borrowers. In addition, IRPAC believes that the low yields and short maturities of short-term debt, as well as the institutional nature of the predominant portion of the holders of short-term debt, mean that there is little risk that creating an exemption for such instruments would result in tax evasion. Thus, IRPAC recommends that interest (including original issue discount) on short-term debt (i.e., debt having a term of 183 days or less) be excluded from the definitions of “withholdable payment” and “financial account,” consistent with the terms and policies implemented by the exemption for such amounts under Chapter 3.

2. Potential Conflicts with Foreign Laws

Recommendation

IRPAC encourages Treasury and the IRS to work with foreign governments to attempt to address the circumstances in which FATCA imposes obligations on foreign financial institutions (FFIs) that would obligate them to violate local legal restrictions. In addition, IRPAC recommends that the IRS take the existence of such restrictions into account in formulating guidance in the proposed and final regulations under FATCA, to the extent such conflicts have not been resolved at the time the regulations are issued.

Discussion

⁵ Staff of the Joint Committee on Taxation, “Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3319, The ‘Hiring Incentives to Restore Employment Act,’ Under Consideration by the Senate (February 23, 2010) (JCT HIRE Act Report) at 45.

⁶ JCT HIRE Act Report at 43.

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The obligations that FATCA imposes on FFIs, in particular participating FFIs, potentially conflict with legal constraints imposed on such FFIs under foreign law in a number of respects. For example, FATCA's reporting requirements potentially contravene the privacy or data protection laws of a number of jurisdictions. (In some jurisdictions, these constraints may be waivable by an FFI's account holders, but some jurisdictions do not treat such waivers as valid.) Although FATCA provides FFIs with a remedy for addressing this problem – requiring that an account be closed if foreign law prohibits disclosure and the relevant account holder fails to waive the application of such law – a number of jurisdictions prohibit the closing of certain types of financial accounts under “requirement to serve” and similar legislation. In addition, certain types of “accounts” are contractual arrangements (e.g., insurance policies and non-regularly traded debt and equity securities) that by their terms may not be cancellable or redeemable. Thus, FFIs may effectively be precluded from complying with FATCA's requirement that these accounts be closed. This issue is particularly problematic in light of Notice 2010-60's suggestion that Treasury and the IRS are considering a rule pursuant to which a participating FFI's agreement may be terminated if the FFI has an excessive number of long-term recalcitrant account holders.⁷ Finally, under the laws of several jurisdictions, FFIs may be precluded from collecting withholding tax required under FATCA, in particular with respect to passthru payments (which, under foreign law, generally would be viewed as local-source income).

IRPAC understands that Treasury and the IRS have been involved in discussions with their counterparts in a number of foreign governments to address these issues. We urge Treasury and the IRS to continue this process, in order to minimize the circumstances in which FFIs will be precluded from signing participating FFI agreements because of local legal restrictions to which they are subject. We also encourage the IRS to be mindful of the legal constraints under which FFIs may be operating in formulating the details of a participating FFI's obligations under the proposed and final FATCA regulations. In particular, a participating FFI should not be at risk of having its participating FFI agreement revoked by reason of its having long-term recalcitrant account holders, if the FFI is prohibited from terminating the relevant account relationships as a result of local legal restrictions to which it is subject. We also recommend that the IRS consider adopting extended transition rules under the regulations to the extent discussions with foreign governments regarding reconciling conflicting legal obligations are ongoing at the time the regulations are finalized.

3. Notice 2011-53 Transitional Relief

Recommendation

IRPAC discussed with the IRS the FATCA transition relief provided in recently released Notice 2011-53. Specifically, IRPAC raised concerns that Notice 2011-53 may still leave too little time for financial institutions to build the required systems, particularly

⁷ See Notice 2010-60, Section V.D.

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if the publication of final regulations is delayed or if withholding obligations on certain categories of withholdable payments that are not subject to withholding under Chapter 3 are not excluded or deferred. IRPAC recommends that the IRS apply transition relief consistently across the financial services industry, and issue further guidance that builds in additional time to allow withholding agents to develop the required systems.

In addition, IRPAC understands from discussions with the IRS that it intends to apply Notice 2011-53's procedures for Chapter 4 withholding on U.S.-source payments to "obvious" FFIs effective January 1, 2014, even if the FFI's account is a pre-existing account. IRPAC recommends that the IRS provide additional guidance concerning the identification of FFIs and the procedures withholding agents will be required to follow in verifying an account holder is an FFI and its status as a participating FFI.

Discussion

At meetings prior to the publication of Notice 2011-53, IRPAC discussed with the IRS and Treasury the need for transition relief to allow withholding agents sufficient time to develop, test, and integrate the necessary systems and procedures. IRS and Treasury have received many comment letters suggesting that a minimum of 18-24 months will be required for this process. Notice 2011-53 appears to be responsive to these requests by providing that withholding on U.S. source Fixed, Determinable, Annual, Periodical (FDAP) payments begin January 1, 2014, withholding on gross proceeds begin on January 1, 2015, and that FFI withholding on pass-thru payments begin no earlier than January 1, 2015. IRPAC appreciates the IRS's recognition of the need for additional time to develop the required reporting and withholding systems, but notes the new dates only provide a maximum 18 month period assuming the IRS publishes final regulations by July 1, 2012. If there is a delay in the publication of final regulations, withholding agents will likely struggle to have the required systems in place within the deadlines imposed by Notice 2011-53.

IRPAC also raised with the IRS the issue that because the FATCA guidance issued to date does not provide relief from withholding or reporting on bank deposit interest or short-term debt, the provisions of Notice 2011-53 require withholding on such payments beginning January 1, 2014. This is inconsistent with the treatment of such payments under the Chapter 3. Moreover, since the intent of Notice 2011-53 was to acknowledge the industry's need for additional time in order to integrate withholding systems for new types of withholdable payments (for example, by delaying withholding on pass-thru payments until January 1, 2015 or later), the Notice creates a disparity in effective dates for what are essentially the same systems development issues.

IRPAC understands from discussions with the IRS that the IRS intends to apply Notice 2011-53's procedures for Chapter 4 withholding on U.S.-source payments to "obvious" FFIs effective January 1, 2014, even if such FFIs' accounts are pre-existing accounts. IRPAC notes that Notice 2010-60 set forth a two-year process for soliciting information from account holders and evaluating that information, even in the case of

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account holders whose names (or other information readily available to the relevant U.S. financial Institute (USFI) or FFI) “clearly indicate” that they are FFIs. Thus, a requirement that withholding be applied with respect to such accounts provides USFIs and FFIs with substantially less time to complete the due diligence process with respect to such accounts than originally indicated in Notice 2010-60. Accordingly, IRPAC recommends that the IRS provide guidance clearly addressing the types of FFI account holders to whom this rule applies and providing clear and straightforward procedures for USFIs and FFIs to easily identify the affected account holders. In addition, IRPAC recommends that the IRS apply these accelerated due diligence requirements only to narrow categories of easily identified FFIs to permit USFIs and FFIs to comply with the due diligence requirements in the shorter time frame that is contemplated.

4. Due Diligence Requirements for Existing Accounts

Recommendation

IRPAC recommends that the account holder file searches provided for in Notice 2010-60, 2011-34, and 2011-53 be limited in scope to a reasonable number of calendar years prior to the date of the search.

Discussion

IRPAC discussed with the IRS the possibility of limiting the historical timeframe for which documents must be searched for indicia of U.S. status. Particularly for private banking accounts, some financial institutions have years of records that can consist of many thousands of pages of documents, and it would be expensive and time-consuming to research all records. Also, financial institutions retain records various ways, such as on paper, microfiche, CDs and optical images, with older records often being housed in places distant from either the compliance or tax operations personnel who would be assigned the task of searching those records. Therefore, IRPAC recommends that the account holder file searches proposed in IRS Notices 2010-60, 2011-34 and 2011-53 be limited in scope to a reasonable number of calendar years prior to the date of the search. To ensure consistency and avoid confusion, the proposed regulations should address the due diligence research standards that the withholding agent should apply.

5. Revisions of Form 1042-S for FATCA Reporting and Withholding

Recommendation

IRPAC recommends the current Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, be revised to include additional income and recipient codes applicable to FATCA reporting and withholding.

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Discussion

In order to accommodate reporting under Chapter 4, the current Form 1042-S could be modified to include additional income and recipient codes. The revised form would include a check box to indicate whether amounts reported on the form were withheld under Chapter 3 or under Chapter 4. In addition, the revised form would include a space for an FFI-EIN (Employer Identification Number).

6. Revision of Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding

Recommendation

IRPAC recommends that the current Form W-8BEN be split into separate forms for individuals and entities.

Discussion

The current version of the Form W-8BEN confuses foreign entities that submit that form for Chapter 3 purposes instead of the accurate type of Form W-8 (Form W-8IMY (Intermediary Certificate for United States Tax Withholding), Form W-8ECI (Foreign Person's Claim of Income Effectively Connected with the Conduct of a Trade or Business in U.S.) or Form W-8EXP (Foreign Organization's Certificate for United States Tax Withholding). In addition, nonresident alien individuals are frequently confused by the current Form W-8BEN because it includes many references applicable to entities. The new Form W-8 to be provided by foreign entities should include statements certifying their entity classification and other issues relevant to their treatment under the new Chapter 4 requirements. This increased complexity is likely to make the form even more confusing for account holders who are required to submit the form. This complexity could be addressed to a significant extent in the case of individuals by creating a separate form, which would not need to address many of the complex issues relevant to entities under Chapters 3 and 4. In addition, it is important for withholding agents to have the opportunity to review a draft of these certification forms contemporaneous with the issuance of proposed regulations. The revised forms should be available for mailings in the second half of 2012 for those existing accounts whose Form W-8 will expire as of December 31, 2012, in order to prevent an additional mailing in 2013 or 2014 to fulfill due diligence requirements contained in the various IRS notices issued to date.

B. Chapter 3. Withholding Tax Issues

Recommendations

IRPAC met with the IRS to discuss Chapter 3 withholding tax issues and made the following recommendations:

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Capacity: The determination of whether the capacity of a person who executes a Form W-8BEN for an entity should be considered valid has been an issue for U.S. withholding agents for many years. IRPAC recommends that the IRS issue guidance to the effect that a U.S. withholding agent may treat a person who has executed a Form W-8BEN for an entity as an authorized representative or officer of the entity regardless of the person's title shown on the Form W-8BEN. IRPAC also recommends that the instructions to the Form W-8BEN be revised to state that an authorized representative means a person who is authorized to sign on behalf of the beneficial owner based on authority granted to that person in, for example, organizational documents, resolutions (or similar documents) or laws applicable to the beneficial owner.

Permanent Residence Address: The instructions to the Form W-8BEN state that the Permanent Residence Address (Line 4) of the beneficial owner should not be the address of a financial institution, a post office box, or an address used solely for mailing purposes. The only address of many offshore investment funds is that of a registered agent or investment advisor. IRPAC recommends that the IRS issue guidance on the acceptability of such an address and the type of additional documentation, if any that is required to validate the form.

Reason for U.S. Address: Current Treasury Regulations require a withholding agent to obtain a reasonable explanation in writing from a payee who provides a Form W-8 with a U.S. address. IRPAC recommends that the IRS issue guidance that the reasonable explanation in writing may be furnished either in a letter from the payee or by a form provided by the withholding agent specifically for this purpose. A form provided by a withholding agent could identify common reasons for a non-U.S. person to have a U.S. address on the Form W-8.

Inconsequential Errors in Documentation: During the course of an IRS withholding tax examination, a variety of errors may be identified on Forms W-8. Some of these errors should clearly invalidate the form because they may impact the reliability of the form itself (e.g., missing information required by the regulations or form instructions, or uncured due diligence issues). However, other detected errors may be minor in nature, and generally should not impact the reliability of the data on the form. IRPAC recommends that the IRS issue guidance stating that errors that do not impact the status of the payee and do not impede withholding agents from processing the Form W-8 correctly should be considered inconsequential in nature, and should not cause the form to be invalid.

Use of copies/faxed/e-mailed Forms W-8: IRPAC met with the IRS and discussed the disparity in standards required under current guidance for the receipt of Forms W-8 and Form W-9, Request for Taxpayer Identification Number and Certification. Specifically, withholding agents may accept Form W-9 via fax, e-mail, or other soft-copy format, but may only rely on Forms W-8 in original hard-copy format. IRPAC recommends that the IRS issue guidance allowing withholding agents to rely on

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copies of Forms W-8 (including those received via fax, e-mail or other similar forms of electronic transmission) if the form is otherwise facially valid.

Use of retroactive Forms W-8 with affidavits: IRS has stated publicly that forthcoming guidance on Chapter 3 withholding issue will curtail current industry practice of obtaining retroactive Forms W-8 to cure undocumented accounts, including documents received when the withholding agent is under examination, by requiring the provision of additional documentation establishing the account holder's status in some circumstances. IRPAC discussed with the IRS the issue of when it is appropriate for withholding agents to rely on retroactive Forms W-8 both with and without an accompanying affidavit of unchanged status. IRPAC recommends limiting any change in current accepted practices to be applied prospectively, to payments made on or after January 1, 2012 (assuming the guidance is released prior to that date). IRPAC also recommends that a requirement to obtain additional documentation be limited to cases where a withholding agent has not obtained a Form W-8 prior to the time a payment is made to a payee.

Discussion

The Form W-8BEN requires the person who signs the Part IV Certification for any entity to enter the capacity in which the person is acting. U.S. withholding agents continue to see many different titles entered for capacity. One major financial institution has compiled a list of over 100 different titles. It is not possible for a U.S. withholding agent to know whether a particular title provides the signer with the actual authority to sign the Form 8-WBEN for a foreign entity. The Certification on the Form W-8BEN does, however, include the following statement, made under penalties of perjury: "I am the beneficial owner (or am authorized to sign for the beneficial owner)...." Based on this language, a U.S. withholding agent should be permitted to treat the signer as authorized, unless the U.S. withholding agent has reason to know that the signer is not authorized.

IRPAC recognizes the need for the Form W-8BEN to contain a permanent residence address that is outside of the United States and that the address should not be a mailing address or an in-care-of address. However, some entities (such as investment funds) have no other address than a mailing or in-care-of address. In such cases the address represents the principal place of business of the entity and generally is the address shown on organizational documents. IRPAC recommends that the IRS issue guidance on the acceptability of such an address and whether any additional documentation (such as an organizational document) is required to validate the Form.

A withholding agent has reason to know that a client's Form W-8 is unreliable or incorrect for purposes of establishing their status as a foreign person, if a U.S. permanent residence or U.S. mailing address appears either on the client's Form W-8 or elsewhere in their account information. However, a withholding agent may treat an

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account holder that is an individual as a foreign person if the withholding agent has in its possession or obtains:

- documentary evidence (which does not include a U.S. address) that has been provided within the past three years, was valid when it was provided, and that supports the account holder's claim of foreign status; *and*
- a reasonable explanation, in writing, supporting the account holder's foreign status.

For a number of reasons, many withholding agents have found it problematic to consistently obtain satisfactorily written letters of explanation from clients. These reasons include, for example, letters that do not contain clear or adequate information to support their foreign status, or letters that are illegible or written in the account holder's native language. Thus, many financial institutions have found it necessary to develop and implement a more practical and reliable approach – essentially, a checklist of possible reasons for a non-U.S. client to have a U.S. address. In the event a client's specific reason is not identified on the checklist, the form also includes a blank space marked "other" in which the client is asked to enter their particular reasonable explanation. Most withholding agents that have used this checklist approach have found that is much more effective than reliance on a letter. Withholding agents should be permitted to use a checklist such as the following:

Reason for U.S. Address Checklist

I am a nonresident alien individual and not a U.S. person, but I have provided a U.S. address for the following reason (please initial the one reason below that applies, or initial "Other" and write in the explanation for your U.S. address):

- I have arranged for another person to receive my mail for personal security or convenience purposes. (Do not select this reason if your permanent residence address on Form W-BEN, Line 4, is in the U.S.)
- I am a student at a U.S. educational institution. (F, J, M or Q visa holders only)
- I am a teacher at a U.S. educational institution, a trainee or intern, or a participant in an educational or cultural exchange visitor program. (J or Q visa holders only)
- I am a foreign government-related individual assigned to a diplomatic post, consulate, embassy or international organization in the U.S.
- I am the spouse or unmarried child (under age 21) of a foreign student, teacher, trainee, intern, exchange visitor, international organization employee, or foreign government-related individual, who lives at the same address
- Other (explain) include as much detail as possible. A general explanation (such as "I live here" or "I work here") is not adequate for U.S. tax purposes.

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IRPAC discussed the issue of inconsequential errors that may invalidate a Form W-8 with the IRS. It was agreed that both IRS examiners and withholding agents would benefit from clear guidance on the types of inconsequential Form W-8 errors that should not invalidate the form. The following is a list of examples of the types of errors that IRPAC believes to be inconsequential:

- An obvious individual that does not check the “individual” checkbox on Line 3.
- An obvious corporation, or one for which the withholding agent has articles of incorporation on file, and that has not checked the “corporation” box on Line 3.
- The permanent residence address or mailing address shown on Lines 4 or 5 is obviously in a foreign country (e.g., Champs d L’Elysees, Paris), but the country name is not completed.
- The name of the applicable treaty country is entered on Form W-8BEN, Part II, line 9(a), but the corresponding box is not checked; or a valid TIN is entered on line 6 of Form W-8BEN, but line 9(b) is not checked.
- The name of the country is entered on Line 9(b) or 9(c) of Form W-8EXP, but the corresponding box is not checked.
- The date of an entity’s IRS determination letter is entered on W-8EXP, Part II, Line 12(a), but the corresponding box is not checked.
- The permanent residence address shown on Line 4 does not have a street name or house number but, as may be customary in that jurisdiction, instead contains a local descriptive location along with the city and country (e.g., the name of an estate in the English countryside, university residence hall, or military base).
- The permanent residence address shown on Line 4 contains a street or avenue, city and country, but does not contain the beneficial owner’s house number (which the withholding agent knows from the beneficial owner’s Know Your Customer documentation).
- When required, a valid U.S. TIN (with hyphens) is entered on Line 6 of Form W-8BEN, or on Line 6 of Form W-8ECI, Certificate of Foreign Person’s Claim That Income is Effectively Connected With the Conduct of a Trade or Business in the United States, but the corresponding checkbox to identify the TIN type is not checked.
- A valid U.S. TIN is inadvertently entered on Line 7 of Form W-8BEN (“Foreign Tax ID Number”) rather than on Line 6.
- The use of customary, unambiguous country abbreviations on lines 4 and 5 of Forms W-8. These may include, for example, UK, CA, GR, HK, JA, MX and NL. Coincidentally, each of these country abbreviations corresponds to country codes assigned by the IRS for use on Forms 1042-S.

Under current guidance, it is generally understood that a faxed or e-mailed form is acceptable for the Form W-9, but it is not clear that this is acceptable for Forms W-8. The Regulations under IRC §6049 provide some relief by allowing for a 90-day grace

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period during which time the withholding agent may rely on a copy. IRPAC discussed this issue with the IRS, noting specifically that withholding agents would like parity in the application of standards of receipt for Forms W-8 and W-9. Furthermore, since an electronic legal document is now uniformly accepted as legally binding (assuming it has an original signature), there is no justification for continuing to require original hard-copy Forms W-8. Unless the withholding agent has reason to know that a Form W-8 via fax or email is not a copy of an original document, then the withholding agent should be able to rely on that form without further due diligence requirements.

IRPAC recognizes that current industry practice on the use of retroactive Forms W-8, with or without an affidavit of unchanged status, to cure accounts with invalid or no documentation at the time of payment is not definitively sanctioned in the regulations or other published guidance.⁸ It has, however, become widespread practice within the industry and accepted by many IRS agents during the course of an examination. IRPAC acknowledges the need to ensure withholding agents do not abuse this practice by deliberately failing to collect tax documentation as part of their procedures. Specifically, IRPAC discussed with the IRS the need to differentiate between withholding agents who have documentation compliance procedures in place, and those who are purposefully negligent, and to modify the allowable use of retroactive forms accordingly.

C. Clarification of Information Reporting Requirements Relating to Commercial Paper

Recommendation

On September 15, 2011, IRPAC submitted a comment letter (see Appendix E) recommending that the IRS clarify the applicability of the information reporting exemption for commercial paper following the enactment of the HIRE Act.

Discussion

The HIRE Act repealed IRC §163(f)(2)(B), effective for debt obligations issued after March 18, 2012. (Section 163(f)(2)(B) generally permits U.S. borrowers to issue debt obligations in bearer form, provided they are issued under arrangements reasonably designed to ensure their sale to non-U.S. persons.) The repeal of this

⁸ Although there is no blanket rule providing that retroactive documentation is sufficient to cure documentation failures, Treasury regulation section 1.1441-1(b)(7)(ii) provides as follows: "Proof that a reduced rate of withholding was, in fact, appropriate under the provisions of chapter 3 of the Code and the regulations thereunder may also be established after the date of payment by the withholding agent on the basis of a valid withholding certificate or other appropriate documentation furnished after that date. However, in the case of a withholding certificate or other appropriate documentation received after the date of payment (or after the grace period specified in paragraph (b)(3)(iv) of this section), the district director or the Assistant Commissioner (International) may require additional proof if it is determined that the delays in obtaining the withholding certificate affect its reliability." See *also e.g.*, Notice 2006-99 (announcing that interest charges based on the amount of tax not withheld will not be imposed if it is ultimately shown that no underlying tax is due); T.D. 9323 (implementing rule set forth in Notice 2006-99).

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provision has created some uncertainty regarding the continued viability of the information reporting exemption for commercial paper,⁹ which incorporates by reference the foreign-targeting procedures of IRC §163(f)(2)(B). IRPAC believes that Congress did not intend to call into question the long-standing information reporting exemption for commercial paper, and believes that maintaining the existing information reporting exemption is important to ensure that the commercial paper market continues to operate efficiently. Thus, on September 15, 2011, IRPAC submitted a comment letter recommending that the IRS clarify that the information reporting exemption for commercial paper will continue in effect following the effective date of the repeal of §163(f)(2)(B). (See Appendix E.)

⁹ Treasury regulation §1.6049-5(b)(10).

Appendix

Appendix A: IRS Notice 2011-39 – 2012 Guidance Priority List

Appendix B: Form W-2 – Reporting the Cost of Healthcare

Appendix C: IRPAC Mockup Substitute Form 1099-B

Appendix D: Comments on Merchant Card, Third-Party Payments Form 1099-K

Appendix E: Announcement 2010-22: Request for Comments Regarding
Implementation of FATCA

Appendix A

IRS Notice 2011-39 – 2012 Guidance Priority List

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

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Internal Revenue Service
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**Emerging Compliance
Issues**

Sub-Group:
Candace Ewell, Chair
Susan Boltacz
Rebecca Harshberger
Anne Jetmundsen
Jerri Langer

Re: IRS Notice 2011-39 – 2011-2012 Guidance Priority List

Dear Commissioner Shulman:

The Information Reporting Program Advisory Committee (IRPAC) appreciates the opportunity to recommend items that should be included on the 2011-2012 Guidance Priority List in response to Notice 2011-39.¹

IRPAC recognizes the challenges the Service faces in developing and implementing new reporting and withholding policies and procedures in light of the ever-growing focus on information reporting and its role in reducing the tax gap. Just within the last few years, legislative changes have expanded information reporting to new levels with the enactment of credit card reporting under Code section 6050W, mandatory 3% withholding under Code section 3402(t), cost basis reporting under Code section 6045, Patient Protection and Affordable Care Act, and Foreign Account Tax Compliance Act. With these additional reporting programs comes a heightened responsibility for IRPAC to fulfill its mission to reduce taxpayer burden and improve the overall administration of information reporting.

In that vein, we strongly recommend that the Guidance Plan include a new subcategory under "Tax Administration" entitled "Information Reporting" that focuses on the efficient implementation and administration of information reporting, with fair consideration of taxpayers (including the reporting community) burdens. This would include an understanding of the lead times needed by the reporting community to implement new programs and changes to existing programs, and consideration of the

**International Reporting
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Sub-Group:
Donald Morris, Chair
Douglas Borisky
Duncan Brenan
Terence Coppinger
Jeffrey Mason
Marjorie Penrod

¹ IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

data requested in light of the availability and costs associated with producing that data, and the usefulness of the data collection.

A number of priority items can be added to this new subcategory, including:

1. Issues Previously Raised By IRPAC. IRPAC produces an annual report that outlines a number of issues that are of critical importance to the reporting community, and should be considered for inclusion on the Guidance Plan. For example, see IRPAC's June 11, 2010 letter in the Appendix to the 2010 report that demonstrates the need for guidance on the last known addresses for businesses.

2. Automatic Extension of Filing Deadlines. Critical to the use of electronic medium used in today's submission of many information returns it is very important to understand that (1) software vendors need sufficient time to create the form in proper electronic format, (2) the payor community requires sufficient processing time once forms (and instructions) are issued in final form by the Service in order to successfully implement changes to information returns (and, with new data elements, to develop procedures to gather and track such data), and (3) with respect to data provided by an outside source (e.g., employers or third party), these parties also require lead time to gather and transmit to their service providers or payors the information requested on the information return. Therefore, compliance is not possible upon the issuance of the final form by the Service, and depending on the form and the extent of the changes, and the availability of the requested data, this deployment process may well extend beyond 18 months.

Accordingly, IRPAC strongly recommends that, at a minimum, the Service should grant an automatic six month extension of any filing deadline if the Service issues the final form (and instructions) within six months of the filing deadline. Moreover, for extensive changes to an existing form (or a new form), an 18-month extension or generous penalty relief provisions are warranted. This extension and penalty relief provisions should be established as a standard IRS practice, which is not dependent on extension requests from the taxpayer community.

3. Increased Commitment to Forms and Publications. The importance of forms and publications can never be overstated, as they are the key to effective compliance with the Internal Revenue Code. Therefore, it is critical to consider these provisions at the onset when developing the rules and dedicate the proper resources so that these materials can be provided timely in order to properly implement the provision. Moreover, engagement of IRPAC at the onset of developing the forms and publications (or changes thereto) will facilitate implementation of the rules. There are numerous examples where a delay in the Service's issuance of the form (and instructions), or a failure to seek IRPAC's input prior to implementing a change, has restricted compliance (e.g., Forms 1099-INT, 1099-B, 1099-K, 1097-BTC, 5305-B, 5305-SB). Accordingly, IRPAC recommends that the Service develop a uniform

procedure of engagement with IRPAC at the onset of the process for developing new forms or changes to existing forms.

Moreover, to the extent that more focus is placed on electronic communications through the Service's website, for example the use of FAQs, while we appreciate the timeliness of this information, it is equally important that the taxpayer (and reporting community) can rely on this information without penalty exposure, and that the information posted cannot be changed without adequate disclosure.

4. De Minimis Exception for Corrected Information Filings. Issuing corrected information returns (e.g., Forms 1099, W-2) for unintended errors and late reclassifications of distributions by issuers that result in a net change of less than \$10 is extremely burdensome on the taxpayer, the reporting community, and the Service. Therefore, we strongly recommend that a de minimis exception be available, making such corrections optional. This approach is consistent with the Code's reporting requirement for many types of 1099s that no return is required for payments under \$10.

* * *

We appreciate your consideration of this matter, and we look forward to our continued working relationship on these important issues.

Respectfully Submitted,



Elizabeth Thomas Dold
2011 IRPAC Chair

Appendix B

Form W-2 – Reporting the Cost of Healthcare

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

Elizabeth Thomas Dold,
Chairperson

Burden Reduction

Sub-Group:

Kathy Ploch, Chair
Julia Chang
Kathryn Tracy
Arthur Wolk
Lonnie Young

**Emerging Compliance
Issues**

Sub-Group:

Candace Ewell, Chair
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Rebecca Harshberger
Anne Jetmundsen
Jerri Langer

Employee

Benefits/Payroll

Sub-Group:

Leonard Jacobs, Chair
Lisa Germano
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Anne Lennan
Emily Lindsay
Michael Lloyd

**International Reporting
& Withholding**

Sub-Group:

Donald Morris, Chair
Douglas Borisky
Duncan Brennan
Terence Coppinger
Jeffrey Mason
Marjorie Penrod

June 28, 2011

Honorable Douglas Shulman
Commissioner of Internal Revenue
Internal Revenue Service
Attn: Leslie Paul
CC:PA:LPD:RU (Notice 2011-28), Room 5203
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Form W-2 – Reporting the Cost of Healthcare

Dear Commissioner Shulman:

The Information Reporting Program Advisory Committee (IRPAC)¹ was established in 1991 as a result of an administrative recommendation contained in the final conference report for the Omnibus Budget Reconciliation Act of 1989. The recommendation suggested that the Internal Revenue Service (IRS) consider "the creation of an advisory group of representatives from the payer community and practitioners interested in the Information Reporting Program (IRP) to discuss improvements to the system."

The IRPAC thanks the Service for timely releasing IRS Notice 2011-28 (interim guidance on informational reporting to employees on the cost of their group health insurance coverage). This Notice answers many questions and provides welcome transition relief. However, there are a number of areas where additional clarifications or relief is needed, which we address more fully below.

- Health Flexible Spending Accounts (FSA). Add an example for a typical FSA arrangement and, to the extent possible, streamline the existing examples.
- Definition of Applicable Employer-Sponsored Coverage. Clarify the interplay between Q&A-12 and Q&A-15 of the Notice and permit the 2% COBRA administrative fee to not be taken into account.

¹ IRPAC was established in 1991 as a result of an administrative recommendation contained in the final conference report for the Omnibus Budget Reconciliation Act of 1989. The recommendation suggested that the IRS consider "the creation of an advisory group of representatives from the payer community and practitioners interested in the Information Reporting Program (IRP) to discuss improvements to the system."

- Health Reimbursement Arrangement (HRA). Permit (but do not require) a reasonable good faith cost estimate to be used for HRAs.
- Self-Funded Dental and Vision Coverage. Clarify that "integrated" refers to the HIPAA definition.
- Hospital Indemnity Plans. Clarify the treatment of hospital indemnity plans that are provided on a pre-tax basis.
- Sick Pay Reporting. Extend the transition relief to include sick pay providers.
- Former Employees. Extend the transition relief to include any former employee, regardless of whether or not he or she is receiving a W-2.
- Amended W-2. Limit the need to issue a W-2c in the event that the "DD" amount was determined in accordance with a reasonable good faith standard.

1. Health Flexible Spending Accounts (FSA)

Q&A 19 (Notice 2011-28), Example 1 is confusing and if the key point is that none of the health FSA amount is taken into account for purposes of determining the aggregate reportable cost if none of the employer flex credit applies to the health FSA, the example can be streamlined. Moreover, we recommend that another example is needed (either in the Notice or the FAQs) that addresses a typical health FSA arrangement, as follows:

Proposed Example – An employer offers a premium conversion plan, allowing employees to pay for the major medical plan through salary reduction. The amount of salary reduction for the major medical plan depends on the tier of coverage selected by the employee. The employer also offers a health FSA. No employer credits are provided to the health FSA. The health FSA is funded only through salary reduction. For purposes of reporting on Form W-2, none of the health FSA amount is taken into account for purposes of determining the aggregate reportable cost, regardless of the amount of salary reduction elected for the major medical plan.

2. Definition of Applicable Employer-Sponsored Coverage

Q&A-12 of the Notice appears to conflict with Q&A-15. Q&A-12 defines applicable employer-sponsored coverage as coverage under a health plan that is excludable from the employee's income under §106, or would be so excludable if it were employer-provided coverage (within the meaning of §106). Q&A-15 provides that the aggregate reportable cost includes any portion of the cost that is includable in an employee's gross income. The interplay between these two provisions should be clarified. For example, is coverage that is imputed as wages required to be counted? Also, please

clarify that the cost of applicable employer-sponsored coverage can exclude COBRA's 2% administration charge.

3. Health Reimbursement Arrangement (HRA)

It would be helpful if IRS stated that while employers are not required to report the value of a health reimbursement arrangement during the transitional relief period, employers can make a reasonable good faith effort to calculate a value and include the HRA cost in the total cost reported, if they so choose.

After the transitional relief period ends, IRS should continue to permit employers to use a reasonable good faith effort to calculate an HRA value.

4. Dental and Vision Coverage

Q&A-20 of the Notice provides transition relief for dental and vision plans that are not integrated into a group health plan. It would be helpful if the Service used the terminology from HIPAA for the definition of "excepted benefits." HIPAA provides a clear definition of what is not an "integral part" of a group health plan.

5. Hospital Indemnity Plans

The questions and answers posted on the IRS website exclude certain types of coverage from the definition of applicable employer-sponsored coverage. One type is coverage only for a specified disease or illness and hospital indemnity or other fixed indemnity insurance, if the employee pays the premiums on an after-tax basis. Clarification is needed as to whether the Service intends for these indemnity plans to be included in the aggregate reporting if they are paid on a pre-tax basis.

6. Sick Pay Reporting

Many employers use third party sick pay providers to handle W-2s for short term and/or long term disability payments. However, there has been no guidance as to whether this reporting obligation extends beyond the "employer." This issue is further complicated by the election between the third party insurance provider and the employer where the provider actually files the Forms W-2 under their EIN. Moreover, sick pay providers are not prepared from a systems standpoint to meet any W-2 health care reporting requirement, and are particularly disadvantaged by the fact that these providers generally do not have access to data regarding the various types of health coverage that the employer is providing to these employees. Therefore, at a minimum, we request that the transition relief be extended to include sick pay providers from having to comply with these provisions.

After the transitional relief period ends, IRS should continue to exempt sick pay providers from this reporting requirement.

7. Former Employee Reporting

Q&A-9 of the Notice should be modified to provide that, at least during the transition period, employers that continue to issue a Form W-2 to a former employee are not required to report the cost of the health coverage. The fact that a former employee is receiving nonqualified deferred compensation, severance pay, group term life insurance, or some other amount that constitutes wages following termination of employment should not trigger this new reporting requirement. The burdens involved with complying with this new provision (as this data is often not available to health care providers and system changes are costly and time consuming) outweigh the benefit to these former employees.

After the transitional relief period ends, IRS should continue to permit employers to exclude former employees from this reporting requirement.

8. Amended W-2

At least during the transition relief period, provide that a calculation of the cost of health coverage under a reasonable, good faith standard does not require that a W-2c be issued to correct the amount of this reporting. In the event that an insurance company provides rebates of premiums, provide that no Forms W-2c will be required.

After the transitional relief period ends, IRS should continue to permit employers to avoid W-2c reporting for reasonable, good faith errors with this reporting requirement.

* * *

IRPAC appreciates the opportunity to comment on the issues addressed herein raised by the Notice 2011-28. Please do not hesitate to contact me if you have any questions regarding the matters addressed in this correspondence.

Sincerely,



Elizabeth Thomas Dold
IRPAC Chair

Appendix C

IRPAC Mockup Substitute Form 1099-B

Proceeds From Broker and Barter Exchange Transactions

OMB No. 1545-0715

2011
Form **1099-B**

SHORT-TERM GAINS OR LOSSES

8 Type of gain or loss: All transactions presented in this portion of the composite 1099-B statement represent short-term gains or losses.

Date of sale or exchange 1a	Quantity	Sale price of stocks, bonds, etc.* 2	Federal income tax withheld 4	Non covered 6	Date of acquisition 1b	Cost or other basis 3	Reported gain or loss 7
9 AKAMAI TECHNOLOGIES / CUSIP: 00971T101							
01/12/11	700.000	9,432.58			08/23/11	9,877.00	(444.42)
01/13/11	200.000	2,584.87			08/23/11	2,822.00	(237.13)
9 ALLIANCE CAPITAL MANAGEMENT CALL / CUSIP: 123456789							
01/16/11	5.000	140.99		✓	02/24/11	0.00	140.99
9 COLUMBIA ACORN SELECT FD / CUSIP: 197199888							
05/10/11	5,078.820	92,434.58		✓	02/05/11	94,466.11	(2,031.53)
05/10/11	2,049.180	37,295.07		✓	02/06/11	40,000.00	(2,704.93)
9 DELAWARE HIGH YIELD / CUSIP: 245908876							
02/05/11	17,688.670	75,000.00		✓	VARIOUS	69,870.28	5,129.72
04/15/11	3,687.600	15,000.00		✓	VARIOUS	14,566.04	433.96
05/17/11	4,603.110	18,000.00		✓	VARIOUS	18,182.28	(182.28)
07/08/11	4,454.360	18,000.00		✓	VARIOUS	17,594.74	405.26
08/25/11	1,580.510	6,464.92		✓	VARIOUS	6,577.08	(112.16)
9 ZIMMER HLDGS INC / CUSIP: 98956P102							
07/26/04	100.000	7,379.82		✓	07/16/11		(367.18)

A single line of description and CUSIP number for all transactions in that security.

Additional legending for substitute composite payee statements.

* Sales price of stocks, bonds, etc. reported to IRS less commissions and option premium.

This is important tax information and is being furnished to the Internal Revenue Service. You are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Where a check mark appears in column 6, the transaction is considered "noncovered" and any amounts with headings 1b, 3, 5 or 7 are provided for your reference and are not reported to the IRS. All other amounts presented in numbered columns or rows for those sales are reported to the IRS as indicated in the preceding paragraph.

NOTE: Using sample data, this document represents one possible presentation of substitute Form 1099-B within a composite statement. It illustrates IRPAC's recommendations regarding minimizing repetition, including information that is not required and incorporating explanatory language.

Alternate presentations might also include items such as:

- state tax withheld
- transaction descriptions (merger, redemption, buy to close, etc.)
- identification of contingent payment debt instruments
- subtotalling by security
- additional information regarding wash sales disallowed
- annotation regarding corporate actions (e.g. proceeds includes fair market value of noncash consideration)
- lot relief method

Proceeds From Broker and Barter Exchange Transactions

OMB No. 1545-0715

2011
Form 1099-B

A single "Box 8 Declaration" for this entire section of the payee statement.

LONG-TERM GAINS OR LOSSES

8 Type of gain or loss: All transactions presented in this portion of the composite 1099-B statement represent long-term gains or losses.

Date of sale or exchange 1a	Quantity	Sale price of stocks, bonds, etc.* 2	Federal income tax withheld 4	Non-covered 6	Date of acquisition 1b	Cost or other basis 3	Reported gain or loss 7
9 DENVER CO CITY & CNTY 5.25% 8/1/08 / CUSIP: 123456789 08/01/11	100,000.000	100,000.00		✓	05/01/00	100,986.00	(986.00)
9 HOME DEPOT INC / CUSIP: 437076102 06/04/11	300.000	10,595.80		✓	06/10/02	11,786.95	0.00
5 Wash Sale Loss Disallowed (1,191.15) 11/15/11	300.000	12,000.00			06/30/11	11,600.00	400.00
9 ISHARES TR RUSSELL 2000 INDEX FD / CUSIP: 464287655 08/29/11 <i>Option premium of \$61.65 included in proceeds</i>	100.000	5,859.90		✓	7/24/2001	4,705.13	1,154.77
08/29/11 <i>Option premium of \$246.59 included in proceeds</i>	400.000	23,439.59		✓	7/02/2001	19,848.51	3,591.08
9 MEDCO HEALTH SOLUTIONS INC / CUSIP: 58405U102 09/25/11	100.000	4,300.00		✓	09/30/99	2,500.00	1,800.00
9 MINNEAPOLIS MN CMNTY DEV AGY 0.0% 3/1/10 / CUSIP: 603924AM3 08/06/11	10,000.000	9,535.00		✓	02/05/99	7,541.20	1,993.80
9 POST PROPERTIES / CUSIP: 737464107 7/15/2011	1,000.000	30,000.00		✓	01/15/10	18,000.00	12,000.00

Investor friendly annotation

Information not required for a noncovered lot. Presented on the payee statement, but not included in the FIRE filing with the IRS.

* Sales price of stocks, bonds, etc. reported to IRS less commissions and option premium.

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Where a check mark appears in column 6, the transaction is considered "noncovered" and any amounts with headings 1b, 3, 5 or 7 are provided for your reference and are not reported to the IRS. All other amounts presented in numbered columns or rows for those sales are reported to the IRS as indicated in the preceding paragraph.

Appendix D

Comments on Merchant Card, Third-Party Payments Form 1099-K

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

Elizabeth Dold,
Chairperson

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Sub-Group:**

Kathy Ploch, Chair
Julia Chang
Kathryn Tracy
Arthur Wolk
Lonnie Young

**Emerging Compliance
Issues**

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**International Reporting
& Withholding**

Sub-Group:
Donald Morris, Chair
Douglas Borisky
Duncan Brennan
Terence Coppinger
Jeffrey Mason
Marjorie Penrod

March 28, 2011

Honorable Douglas Shulman
Commissioner of Internal Revenue
Internal Revenue Service
Attn: Yvette Lawrence
Room 6129
1111 Constitution Avenue, N.W
Washington, DC 20224

RE: Comments on Merchant Card, Third-Party Payments Form 1099-K

Dear Commissioner Shulman:

The Information Reporting Program Advisory Committee (IRPAC)¹ is pleased to submit the following comments regarding Form 1099-K reporting for Merchant Card and Third-Party Payments, which implements the rules set forth in section 6050W of the Internal Revenue Code of 1986, as amended, (IRC),² and Treasury Decision ("T.D.") 9496.³ Although this correspondence is submitted in response to the IRS's Notice and Request for Comments Regarding Form 1099-K (Feb. 11, 2011), the significant effect of the payment card rules prompted IRPAC to provide additional comments on substantive issues that have been raised in the taxpayer and reporting communities following the issuance of the final section 6050W regulations.

As more fully described below, based upon the sweeping effect of the final section 6050W regulations, open questions and uncertainty related to the scope of these rules, the substantial compliance burden on those required to comply, and lack of clear guidance that raises significant noncompliance concerns, IRPAC strongly urges Treasury and the IRS to:

¹ IRPAC was established in 1991 as a result of an administrative recommendation contained in the final conference report for the Omnibus Budget Reconciliation Act of 1989. The recommendation suggested that the Internal Revenue Service ("IRS") consider "the creation of an advisory group of representatives from the payer community and practitioners interested in the Information Reporting Program (IRP) to discuss improvements to the system."

² Hereafter, all section references are to the Internal Revenue Code.

³ The Treasury Regulations promulgated or revised under T.D. 9496 include the following: Treas. Reg. §§ 1.6041-1, 1.6041A-1, 1.6050W-1, 1.6050W-2, 31.3406(b)(3)-5, 31.3406(g)-1, 31.3406(a)-2, 31.3406(b)(3)-5, 31.3406(d)-1, 31.6045-4, 301.6721-1, and 301.6722-1.

1. Postpone the current effective dates for both reporting and backup withholding by at least one additional year, or otherwise make the reporting optional for 2011, at least for third party networks that have been historically reported on Form 1099-MISC, and provide ample relief during the transition period.⁴
2. Issue guidance in whatever form necessary -- revised regulations, notices, FAQs, form instructions, etc. -- to limit, where necessary, the application of these rules and to provide much needed guidance. This guidance should:
 - a. Limit the scope of the term "third party payment network," and define the key terms referenced therein: (i) substantial number of providers of goods or services, (ii) guarantee, and (iii) central organization.
 - b. Provide a broad exclusion for healthcare payments (regardless of the funding arrangement), which have historically been reported on Form 1099-MISC.
 - c. Provide a broad exclusion for all accounts payable processing arrangements (regardless whether the processing is performed by the purchaser of the goods or services, an affiliate or other related party, or a third party), which have historically reported reportable payments on Form 1099-MISC.
 - d. Apply the non-U.S. payor documentation requirement for foreign payees to all payors.

I. SECTION 6050W REGULATIONS GENERALLY

The regulations issued under T.D. 9496 have a dramatic effect on the information reporting and backup withholding landscape and on compliance responsibilities for payors in general. In the case of payment cards, the new Form 1099-K and final section 6050W regulations reduce the compliance burden on payment card users by shifting the reporting burden to merchant acquiring entities. In the case of third party networks, however, organizations that did not foresee that the potential scope of the section 6050W rules could impact their reporting obligations have discovered that their organizations are either required to report under section 6050W or are possibly required to report under section 6050W. Further, the rules require reporting of the gross amount of reportable payment transactions on a monthly basis on new Form 1099-K. This new approach to reporting and the very short time horizon between the promulgation of the final regulations on August 16, 2010, the effective date for

⁴ This would mean that the reporting on Form 1099-K would be required for payments made on or after January 1, 2012, and the backup withholding requirements would be required for payments made on or after January 1, 2013.

reporting of transactions (and the need to track such transactions) occurring on or after January 1, 2011, and the issuance of the new Form 1099-K on January 18, 2011, allows insufficient time for many reporting organizations to determine whether they, in fact, must report and, if so, whether they can establish the necessary procedures and systems to reasonably comply with the rules. The fact is that many reporting organizations simply cannot timely comply with these rules. Accordingly, the IRS should issue supplementary guidance to clarify the effect of the final section 6050W regulations and Form 1099-K instructions and extend by at least one year both the reporting and backup withholding requirements currently in place. In addition, the IRS should liberally grant penalty relief for those reporting organizations that attempt to comply but encounter difficulty doing so.

II. SIGNIFICANT ISSUES RELATED TO THIRD PARTY NETWORKS

One of the greatest areas of confusion regarding Form 1099-K and section 6050W compliance relates to the meaning of "third party payment network." Treas. Reg. § 1.6050W-1(c)(3) provides that the term "third party payment network" means:

[a]ny agreement or arrangement that --

(A) Involves the establishment of accounts with a central organization by a substantial number of providers of goods or services who are unrelated to the organization and who have agreed to settle transactions for the provision of the goods or services to purchasers according to the terms of the agreement or arrangement;

(B) Provides standards and mechanisms for settling the transactions; and

(C) Guarantees payment to the persons providing goods or services in settlement of transactions with purchasers pursuant to the agreement or arrangement.

The above definition of "third party payment network" in the final regulations is very similar to the statutory definition set forth in section 6050W(d)(3).⁵ Congress defined "third party payment network" broadly to capture specific arrangements that had previously eluded the information reporting provisions of the tax law (*i.e.*, PayPal and

⁵ The breadth of the definition of third party payment network potentially implicates arrangements not intended to be covered by section 6050W. For example, IRPAC members have observed that an expansive reading of the third party network provisions in the final section 6050W regulations could potentially implicate common commercial arrangements involving the transfer of accounts receivable. IRPAC does not believe that Congress intended such arrangements to be subject to reporting as third party payment networks nor does IRPAC believe that the IRS contemplated such arrangements when it developed the section 6050W regulations.

similar arrangements) and subject them to information reporting.⁶ Congress did not intend to "reinvent the wheel," however, by complicating, substituting, or duplicating information reporting standards for arrangements and transactions that had been previously subject to reporting under section 6041.⁷ To prevent duplication and tension between sections 6041 and 6050W, Congress granted Treasury authority under section 6050W(g) to promulgate regulations or other necessary guidance.

The final section 6050W regulations addressing third party network transactions urgently require additional development to address the meaning of key terminology, to more carefully harmonize the reporting under sections 6041 and 6050W, and to clearly identify those arrangements subject to reporting under section 6050W. IRPAC is very concerned that without such further development the transition to reporting under section 6050W will be exceptionally difficult for both the IRS and those required to report on Form 1099-K.

A. Definitions Needed for Key Terms

The third party network regulations use terms that must be clearly defined in order to properly understand the scope of reporting and properly apply the regulations. These terms include, "substantial number of providers of goods or services," "guarantee," and "central organization."

1. Substantial Number of Providers of Goods or Services

Under the final section 6050W regulations, in order for an agreement or arrangement to constitute a third party payment network, it must, among other things, involve the establishment of accounts with a central organization by a *substantial number* of providers of goods or services who are unrelated to the organization and who have agreed to settle transactions for the provision of goods or services to purchasers according to the terms of the agreement or arrangement. Treas. Reg. § 1.6050W-1(c)(3)(A). (Emphasis added). The correlative language in section 6050W(d)(3)(A) refers to a substantial number of persons rather than to a substantial number of providers of goods or services. Moreover, neither section 6050W nor the final section 6050W regulations touch upon the meaning of the term "substantial number" for purposes of these provisions.

In the context of a third party payment network, the only guidance regarding the term "substantial number" is provided in the Technical Explanation of Division C of H.R.

⁶ The House Ways and Means Report on the Alternative Minimum Tax Relief Act of 2008, includes the Committee's report on section 6050W and a section entitled "reasons for change." Following a general statement regarding information reporting of credit card and other electronic payment transactions, the report states "[g]enerally, business receipts that are subject to information reporting are less likely to be underreported by taxpayers." This infers that the legislative intent of section 6050W was to subject transactions to reporting -- generally credit card and electronic payment transactions -- that were not previously subject to reporting in order to improve compliance with the tax law. H.R. Rep. No. 110-728, at 35 (2008).

⁷ *Id.*

3221, the "Housing Assistance Tax Act of 2008" prepared by the Staff of the Joint Committee on Taxation [JCX-63-08, 7/23/2008] (the "JCT Report"). There, the term "third party payment network" is defined (in part) as any agreement or arrangement which involves the establishment of accounts with a central organization by a substantial number of persons (*e.g., more than 50*) who are unrelated to such organization, provide goods or services, and have agreed to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement. (Italics provided).

Thus, for purposes of determining whether the substantial number requirement for establishing a third party payment network is satisfied, existing guidance offers as an example of the requisite number, persons who number more than 50. This guidance is insufficient to enable a third party organization to determine its status as a third party settlement organization. If a putative third party settlement organization takes the position that an agreement or arrangement lacks a substantial number of providers of goods or services to establish the existence of a third party payment network and the IRS disagrees on audit, the third party organization may potentially be subject to penalties and backup withholding. Accordingly, additional guidance is necessary regarding this issue. For example:

- It is not clear whether the reference to "e.g., more than 50" in the JCT Report is intended to provide a safe harbor or a bright line rule. Under what circumstances is the third party organization able to rely on treating an arrangement with 50 or fewer providers as not involving a substantial number and, therefore, as not a third party payment network? Under what circumstances should the third party organization be able to demonstrate that merely having an arrangement with more than 50 providers at a particular point in time does not necessarily constitute a substantial number for purposes of the third party network rules?
- Is each *person* (the term used in the Code and the JCT Report) to be treated as a separate *provider of goods and services* (the term used in the final section 6050W regulations) and is each provider of goods to be construed as satisfying the definition of "person" under section 7701(a)(1)? Thus, if the provider is a partnership with 20 partners, how is this arrangement counted for purposes of the substantial number requirement? Similarly, how does a taxpayer determine the number of providers of goods or services when a bill for services is submitted and payment is received by a single payee that covers services provided by persons who are owners, independent contractors or employees of that payee?

IRPAC believes that rules must be provided to determine whether an arrangement "involves a substantial number of providers of goods or services." Further, these rules must be set forth in a manner that allows ready and consistent application by both third party settlement organizations and the IRS, and that are consistent with the spirit of the

JCT Report language and the section 6050W reporting requirements. IRPAC submits that a bright line test is necessary for application of this rule.

IRPAC recommends that such a rule should provide that the arrangement does not involve a substantial number of providers in a calendar year if, for any day in the calendar year, the number of providers that accept payments from the taxpayer in settlement of accounts does not exceed 50. This provision is consistent with the JCT Report language, is easily administered, and provides a reasonable rule for seasonal businesses and for taxpayers who are starting up or winding down a business. The rule should also specifically provide that a provider that receives payment on behalf of others under the aggregated payees rule or otherwise should be counted as one provider for purposes of the substantial number of providers requirement. Otherwise, third party settlement organizations would have the difficult, if not impossible, task of determining the various kinds of sub-arrangements that may underlie the arrangement between the third party settlement organization and the providers receiving payments.

2. Guarantee

Section 6050W(d)(3)(C) and Treas. Reg. § 1.6050W-1(c)(3)(C) require that in order for an agreement or arrangement to constitute a third party payment network, it must, among other things, guarantee payment to persons providing goods or services in settlement of the transactions subject to the agreement or arrangement. Neither the statute nor the final regulations set forth the meaning of "guarantee" for this purpose or the factors that establish the existence of a guarantee.⁸ IRPAC believes that the term "guarantee" is a term of art and can be ambiguous,⁹ and, therefore, the IRS should issue guidance to define the meaning of "guarantee" for purposes of Form 1099-K and the section 6050W regulations so those third party settlement organizations potentially subject to reporting can properly understand and apply the standard.¹⁰

The term "guarantee" has been defined as "[a]n agreement by which one person assumes the responsibility of assuring payment or fulfillment of another's debts or obligations."¹¹ Black's law dictionary defines "guarantee" as [t]he assurance that a contract or legal act will be duly carried out."¹² In most U.S. jurisdictions under the statute of frauds, a guarantee (a/k/a a surety) -- an arrangement by which one party, the guarantor, assumes responsibility for the debt obligation of another -- must be in writing to be enforceable against the guarantor. In cases in which the guarantor acts

⁸ The term is sometimes spelled "guaranty" in legal writing. See Black's Law Dictionary 772 (9th ed. 2009).

⁹ For example, the language in UCC § 3-419(d) seems to imply that there is a distinction between a guarantee of payment and a guarantee of collection.

¹⁰ In a number of situations, the Internal Revenue Code and the Treasury Regulations address situations involving guarantees. For example, Treas. Reg. §§ 1.166-8 and 166-9 address circumstances involving the deductibility of bad debts when the debts are subject to guarantees, and under the "at-risk" rules set forth in Prop. Treas. Reg. § 1.465-6(d) when a guarantor's amount at risk is increased on account of a repayment guarantee.

¹¹ See The American Heritage College Dictionary 603 (3rd ed. 2000).

¹² See Black's Law Dictionary 772 (9th ed. 2009).

for its own benefit, however, a written agreement may not be required in certain jurisdictions.¹³ Thus, the term "guarantee" is subject to interpretation based upon various meanings and requirements under state and commercial law. Accordingly, it is necessary to provide guidance regarding the meaning of "guarantee" for those potentially subject to third party network reporting requirements.

For this purpose, IRPAC believes that a guarantee should mean an enforceable legal obligation on the part of the third party settlement organization to make payment to the provider of goods or services and that such obligation must be set forth clearly and unambiguously in a written agreement under which both the third party settlement organization and the provider of goods or services are parties. Reporting under section 6050W should not be a nuanced determination where taxpayers are left guessing as to the applicability of the requirement. Further, where a putative third party settlement organization that makes payments to providers of goods or services promises to, and ordinarily does, make prompt payments from its own funds or from the funds of the recipient of goods or services, but is not legally required to provide payment if, for example, the purchaser of the goods or services can no longer fund its obligations, the agreement or arrangement should not constitute a qualifying arrangement because the putative third party settlement organization does not provide a payment guarantee for purposes of the third party network rules.

Vague or ambiguous arrangements whereby a putative third party settlement organization is not under a clear legal duty to make such payments should not be subject to the requirements of section 6050W. IRPAC believes that qualifying guarantee agreements or arrangements could be two party or multiple party agreements or arrangements. That is, the agreements or arrangements may involve only the third party settlement organization and the providers of the goods or services, or alternatively such agreements or arrangements could involve multiple parties, including the third party settlement organization, the providers of the goods or services, and the purchasers of the goods or services. In either case however, the existence of a guarantee under the terms of the agreement or arrangement must be clear and legally binding.

3. Central Organization

Lastly, the relationship between a putative third party settlement organization and the provider of goods or services is critical in determining the existence of a third party payment network under Treas. Reg. § 1.6050W-1(c)(3). In particular, a third party payment network does not exist when the payor is related to the provider of goods or services. Treas. Reg. §§ 1.6050W-1(c)(3)(i)(A) and 1.6050W-1(d)(5). It is unclear under the final section 6050W regulations, however, whether a third party payment network can exist when a putative third party settlement organization is related to the purchaser of the goods or services. Such a determination is critical when evaluating any potential third party network transaction.

¹³ This exception is referred to as the "main purpose rule."

An example of an arrangement in which the relationship between the putative third party settlement organization and the purchaser of goods or services is critical is a "shared services" arrangement. Example 18 in the final section 6050W regulations addresses a scenario involving the processing of accounts payable by a shared-service organization that is unrelated to both the purchasers of goods or services and to the providers of goods or services.¹⁴ The example concludes that the shared-service organization is a third party settlement organization under Treas. Reg. § 1.6050W-1(c)(2) and that the arrangement constitutes a third party payment network under Treas. Reg. § 1.6050W-1(c)(3). It is unclear in the example, however, whether this conclusion changes in a true "shared-service" arrangement in which an entity purchasing the goods or services is related to the entity performing the shared-service function. Based upon the flush language of the final regulations, it is unclear whether such an arrangement constitutes a third party payment network. Nevertheless, IRPAC does not believe that either Congress or the IRS intended for arrangements between purchasers of goods or services and related settlement organizations to constitute third party payment networks.

To resolve this issue, IRPAC strongly urges the IRS to issue guidance defining the term "central organization" as an organization that is unrelated, within the meaning of Treas. Reg. § 1.6050W-1(d)(5), to the purchaser of the goods or services.

B. Harmonization of Sections 6041 and 6050W

Congress enacted section 6050W with a focus on a transaction-based reporting model generally used by financial institutions (*e.g.*, banks, credit card companies, etc.). This approach is fundamentally different from the payment-based reporting model ordinarily used by non-financial businesses (*e.g.*, reporting on Forms 1099-MISC in connection with the processing of accounts payable) in which payments are made following the receipt of an invoice, and reporting on Forms 1099-MISC is based upon actual gross payments made during the calendar year. Applying the reporting requirements of section 6050W to traditional, non-financial businesses previously subject to reporting under section 6041 is a sea change for such organizations and the implementation burden -- both administrative and economic -- is substantial. For these reasons, the harmonization of sections 6041 and 6050W is exceptionally important, and the careful exercise of the power granted to Treasury and the IRS under section 6050W(g) is necessary to ensure a realistic and efficient transition to Form 1099-K reporting.

Congress granted Treasury the authority under section 6050W(g) to prevent section 6050W from displacing functional, well established, and effective information reporting mechanisms already in place under section 6041. The final section 6050W regulations issued in August of 2010, amended the regulations under section 6041 to provide that transactions otherwise "subject to reporting under both sections 6041 and

¹⁴ The use of the term "shared service" in example 18 is a misnomer. Typically, shared service arrangements only exist in the context of related parties. The term "total outsourcing" is generally used to describe arrangements involving the performance of such services by third parties.

6050W are reported under section 6050W and not section 6041." Treas. Reg. § 1.6041-1(a)(1)(iv). In other words, the final section 6050W regulations adopt a standard whereby section 6050W *always* trumps section 6041 when a transaction is potentially subject to reporting under both sections.

IRPAC does not believe that this universal approach to harmonize sections 6041 and 6050W is the best or most effective approach in the case of third party network transactions.¹⁵ IRPAC believes that those third party arrangements that were previously subject to reporting under section 6041, a reporting process that worked very well for many years, should remain under section 6041 and not shift to section 6050W. The economic and administrative burden created by shifting reporting for such arrangements to section 6050W reporting appears to outweigh the benefits likely to be realized from this significant change.¹⁶ Moreover as pointed out previously in this correspondence, the universal harmonization approach used in the final section 6050W regulations seems inconsistent with Congressional intent to the extent that it displaces efficient and functional information reporting practices.

Two examples of situations in which Treasury and the IRS should allow the information reporting requirements under section 6041 to remain in effect are the reporting of medical and healthcare payments and third party accounts payable processing arrangements (addressed separately in parts III and IV, respectively). Accordingly, IRPAC urges Treasury and the IRS to issue guidance and modify the language of Treas. Reg. § 1.6041-1(a)(1)(iv), as necessary, to allow long-standing section 6041 reporting to remain in effect for functional and well-established reporting situations.

III. ALL MEDICAL PAYMENTS MADE BY HEALTHCARE NETWORKS SHOULD BE TREATED CONSISTENTLY AND EXEMPTED FROM THE REPORTING REQUIREMENTS OF SECTION 6050W.

In addition to the traditional accounts payable functions that have always been covered under section 6041, IRPAC strongly urges the IRS to exempt both fully-insured and self-insured healthcare arrangements from reporting medical and healthcare payments on Form 1099-K,¹⁷ as well as those payments otherwise exempted from reporting since

¹⁵ IRPAC was concerned that a broad, overreaching approach regarding third party networks would be disruptive to businesses, and it cautioned the IRS on this issue in correspondence submitted on January 20, 2010. At that time, IRPAC recommended that existing reporting under section 6041 should remain in place rather than replace such reporting with new rules under section 6050W.

¹⁶ As of the date of this letter, Congress appears poised to repeal the expanded Form 1099 reporting passed under the Patient Protection and Affordable Care Act of 2010, so the notion that the reporting of property purchases and payments to corporate payees is critical in the context of all third party network arrangements that are already compliant with the requirements of section 6041 should not be a factor.

¹⁷ Before the issuance of the final section 6050W regulations, medical and health care payments under both fully-insured and self-insured healthcare arrangements were reportable in box 6 of Form 1099-MISC. Those healthcare arrangements not implicated by the final section 6050W regulations continue to be required to report medical and health care payments in box 6 of Form 1099-MISC. Special exceptions preclude reporting of payments made under employee flexible spending arrangements

such amounts have also always fallen under sections 6041 and 6041A.¹⁸ The preamble to the final section 6050W regulations contemplates that certain self-insured arrangements could constitute third party payment networks, and that reportable payments made under such arrangements would be reported on Form 1099-K. Because such payments are already subject to reporting on Form 1099-MISC for both fully-insured and self-insured healthcare arrangements, IRPAC believes that reporting under section 6050W for payments made by a subset of self-insured healthcare arrangements that happen to satisfy the broad definition of third party payment network under section 6050W(d)(3) and Treas. Reg. § 1.6050W-1(c)(3) frustrates rather than enhances Federal information reporting for healthcare payments.

IRPAC also believes that requiring separate reporting on Form 1099-K for effected healthcare arrangements will be administratively burdensome and economically costly for payors, confusing for payees and of little enforcement value for the IRS. Health insurers have informed IRPAC members that the aggregate estimated compliance costs to implement the information reporting requirements of section 6050W for payments to healthcare providers will exceed \$50 million industry wide in the first year, and prospective costs to comply with the duplicative, split reporting for payments to the same providers on Forms 1099-MISC and Forms 1099-K (*e.g.*, duplicative software, IT, printing, postage, etc.) based upon the type of plan triggering the payment (fully insured or self-funded) will be significant. Importantly, the payments at issue are already subject to reporting on Forms 1099-MISC.

As noted above, section 6050W(g) grants Treasury the authority to issue regulations or other guidance to prevent duplicative reporting, and IRPAC believes that a comprehensive exemption from section 6050W reporting for healthcare networks is warranted. IRPAC recognizes that a broad definition of "third party payment network" was necessary under the statute and regulations to facilitate reporting under section 6050W, but in this particular case, an exemption is necessary to retain the long-standing reporting of healthcare payments and to prevent needless confusion, encourage administrative efficiency for payors, contain costs in an industry where cost containment is paramount, and foster effective tax reporting of healthcare payments.

("FSA") under section 106(c)(2) or health reimbursement arrangements ("HRA") treated as employer-provided coverage under an accident or health plan under section 106. When payments are made from FSAs and HRAs, they are exempt from Form 1099 reporting even if made to a medical provider under section 6041(f). It is not clear whether the exemption applies to payments for medical services through health savings accounts ("HSA"). Section 6041(f) predates the creation of HSAs and does not address them, but the vehicles are similar and many practitioners believe that the exemption should extend to cover HSAs.

¹⁸ Treas. Reg. § 1.6041-3(p)(1) exempts payments to (a) a hospital or extended care facility which qualifies as a tax exempt charitable organization; or (b) a hospital or extended care facility owned and operated by the U.S., a state, the District of Columbia, or a U.S. possession (or a political subdivision or an agency or instrumentality of any of the foregoing). In addition, payments to pharmacies are also not subject to reporting. *See* Situation 4 in Rev. Rul. 70-608, 1970-2 C.B. 268.

IRPAC understands that health insurers participating in Administrative Services Contracts ("ASC") or Administrative Services Only ("ASO") arrangements¹⁹ and independent third party administrators ("TPAs") -- those healthcare organizations potentially implicated as third party settlement organizations in the preamble to the final section 6050W regulations -- universally concluded following the issuance of the proposed regulations that healthcare networks were fully exempt from reporting under section 6050W.²⁰ This belief was reasonable in light of the discussion of the issue set forth in the preamble to the proposed section 6050W regulations. Specifically, the preamble to the proposed regulations included two paragraphs that discussed healthcare networks. The first paragraph discussed healthcare networks broadly, and makes reference to both fully-insured and ASC (self-insured) arrangements. Without adequately distinguishing fully-insured healthcare arrangements from self-insured arrangements, the second paragraph states that "health carriers operating healthcare network are outside the scope of section 6050W" and concludes that "because the purpose of a healthcare network is not to enable buyers to transfer funds to sellers, a healthcare network is not a 'third party payment network' within the meaning of the proposed regulations."²¹ IRPAC believes that the IRS would have been inundated with comments from the healthcare industry had the proposed regulations clearly explained that self-insured arrangements could be subject to reporting under section 6050W.

IRPAC submits that those payors (insurers) under ASC and ASO arrangements and TPAs potentially subject to reporting under section 6050W for payments to healthcare providers were caught completely unaware and by surprise by the discussion of self-insured arrangements in the preamble to the final section 6050W regulations and will have significant difficulty complying with these rules for 2011. In addition, insurers that administer both fully-insured and self-insured healthcare arrangements have universally expressed concern to IRPAC members that distinguishing between payments to healthcare providers in order to report correctly on Forms 1099-MISC and Forms 1099-K will be exceptionally difficult and costly because payments are often made to healthcare providers that satisfy charges for both fully-insured and self-insured participants.

IV. ALL ACCOUNTS PAYABLE PROCESSING ARRANGEMENTS SHOULD BE TREATED CONSISTENTLY AND EXEMPTED FROM THE REPORTING REQUIREMENTS OF SECTION 6050W.

IRPAC strongly urges the IRS to exempt all accounts payable processing arrangements from reporting transactions with providers of goods or services on Form 1099-K,

¹⁹ ASC and ASO arrangements are arrangements under which an employer hires a third party to administer employee benefit services to the employer. Such services typically include health claims processing, including adjudication of claims, and billing.

²⁰ After the proposed section 6050W regulations, the IRS received no comments from health insurers regarding ASC/ASO arrangements or TPAs regarding self-funded health plans. The IRS received a single comment regarding self-funded insurance arrangements (Document: IRS-2009-0032-0005) on December 30, 2009, from Roger O. Longenbach of Triple S Petroleum.

²¹ Preamble to Proposed Regulations under Section 6050W, 74 Fed. Reg. 61294, 61297 (Nov. 24, 2009).

including third party accounts payable arrangements. Payments to providers under accounts payable processing arrangements have historically been subject to the provisions of section 6041 and reportable payments are reported on Forms 1099-MISC. For the reasons discussed herein, this well-established and effective practice should be allowed to continue.

There are three fundamental approaches to accounts payable ("AP") processing: an in-house AP department, a shared-service AP arrangement, and a total outsourcing (*i.e.*, third party) AP arrangement. An in-house AP department is an accounting function of the purchaser of goods and services by which the purchaser makes payments directly to sellers on the purchaser's own behalf. As stated in the preamble to the proposed regulations, such a department is not a "third party" and, therefore, is not a third party settlement organization of a third party network.

A shared-service AP arrangement typically provides for a single entity (which may be domestic or foreign) within an affiliated group to process the AP for all or a subset of the members of the group. This arrangement does not differ materially from the in-house model, discussed above, except that in the shared-services arrangement, the AP function is housed in a separate related entity rather than in a separate department or division of the purchaser. The legal formality of a separate but related entity should not result in treating a shared-services AP arrangement differently from an in-house arrangement for purposes of section 6050W. Moreover, as discussed above under "Central Organization" (in part II.A.3) IRPAC believes that in a shared-services AP arrangement, the related AP entity does not constitute a central organization, and therefore, is not a third party settlement organization of a third party payment network.

Under a total outsourcing AP arrangement, the AP function of a purchaser of goods or services is conducted by an entity that is unrelated to that purchaser (*i.e.*, a true third party). The AP processing activities performed under a shared-service AP arrangement and the AP processing activities performed under a total outsourcing arrangement are identical and reportable payments made under both arrangements are subject to reporting under section 6041.

IRPAC believes that all AP processing arrangements (in house, shared-service, and total outsourcing) should remain subject to the information reporting rules under section 6041 and not subject to reporting under section 6050W because the only distinction between such arrangements is that the AP processor in total outsourcing arrangements is a third party. No other substantive differences exist that should necessitate a different reporting regime, including the fact that all three types of AP processing arrangements are subject to section 6041 reporting and have been for years. Accordingly, IRPAC believes that the introduction of Form 1099-K reporting to total outsourcing AP arrangements is inconsistent with Congressional intent, inconsistent with other AP processing arrangements, and administratively and economically inefficient for third party AP processors and the IRS.

V. ONEROUS AND DISPARATE TREATMENT OF U.S. PAYORS UNDER TREAS. REG. § 1.6050W-1(a)(5)(ii) CREATES SUBSTANTIAL COMPETITIVE DISADVANTAGES FOR U.S. PAYORS IN FOREIGN MARKETS AND SHOULD BE IMMEDIATELY REMEDIED.

IRPAC recognizes the pressure on Treasury and the IRS to stem the tide of U.S. tax evasion and to narrow the Federal tax gap. IRPAC also recognizes that this requires action, including the need for rulemaking and increased enforcement. Nevertheless, IRPAC believes that the creation of rules that unquestionably and dramatically skew the competitive playing field against U.S. payors attempting to compete in foreign markets directly or through foreign affiliates is ill advised, especially when the U.S. fisc is unlikely to recognize any appreciable economic benefit.

The establishment of a rule that requires U.S. payors to obtain tax documentation from foreign payees while largely exempting non-U.S. payors from the same requirement, not only prejudices U.S. payors in foreign markets but seems inconsistent with Congressional intent.²² The creation of rules that dramatically disadvantage the competitiveness of U.S. businesses in foreign markets should only occur for substantial and compelling reasons because such rules threaten the existence and profitability of businesses that the Federal government seeks to tax. The rule set forth in both the proposed and final section 6050W regulations does not seem to be supported by economic benefits to the U.S. fisc sufficiently compelling to justify the economic harm likely to be sustained by U.S. payors competing abroad. Accordingly, IRPAC believes that a single standard under Treas. Reg. § 1.6050W-1(a)(5)(ii) for both U.S. payors and non-U.S. payors must be applied. IRPAC believes that given the nature of the significant tax and economic policy concerns with respect to this specific issue, the establishment of such a disparate standard between U.S. and non-U.S. payors should be reserved for Congress.

Specifically, Treas. Reg. § 1.6050W-1(a)(5)(ii) requires U.S. payors to obtain tax documentation from foreign payees -- generally foreign merchants for payment cards and both foreign merchants and non-merchants for third party payment networks -- that satisfies the requirements found in Treas. Reg. § 1.1441-1(e)(1)(ii).²³ Such documentation may be a completed Form W-8BEN, a U.S. taxpayer identification number ("TIN"), or other official documentation that establishes the foreign payee is a foreign person. Without this documentation in hand, U.S. payors must impose backup withholding (currently 28%) under section 3406 for payments made on or after January 1, 2012. Conversely, unless non-U.S. payors have reason to believe that a foreign

²² IRPAC made this point previously in comments submitted to the IRS on January 20, 2010. Section 6050W(d)(1)(B) provides that the term "participating payee" does "not include any person with a foreign address."

²³ The final section 6050W regulations use a very broad definition of "U.S. payor or middleman" that includes not only U.S. payment settlement entities, but also foreign branches and controlled foreign corporations ("CFCs") of a U.S. payment settlement entity. *See* Treas. Reg. § 1.6049-5(c)(5). The effect of this standard means that the subsidiaries of U.S.-based multinationals that act as payment settlement entities are generally subject to these rules and are similarly disadvantaged compared to non-U.S. payors.

payee is a U.S. person, non-U.S. payors are not required to obtain any such documentation from foreign payees and may rely on the fact that the foreign payee has a foreign address. This documentation requirement foisted on the foreign accounts of U.S. payors may seem innocuous to seasoned U.S. tax practitioners, but to wholly foreign merchants with no U.S. connection whatsoever, applying to the U.S. taxing authorities for a TIN or completing a Form W-8BEN is disconcerting.²⁴ This reality coupled with the fact that a similar requirement is not imposed on non-U.S. payors that compete side by side with U.S. payors for the same accounts has an obvious and profound effect on the foreign business of U.S. payors. That is, foreign merchants faced with a burdensome requirement for doing business with U.S. payors will likely just decline to do their payment card and third party payment business with U.S. payors and opt to do business with non-U.S. payors not subject to these rules.²⁵

IRPAC does not believe that either Treasury or the IRS intended to dramatically impede the competitiveness of U.S. payors in foreign markets, but IRPAC believes that this is the practical effect of the foreign payee standard imposed on U.S. payors under the final section 6050W regulations. In testimony at the Public Hearing on Proposed Regulations under Section 6050W on March 15, 2010, (the "Hearing"), representatives of companies adversely affected by the foreign payee rules testified on how their businesses would suffer under those rules. Some excerpts from that testimony are set forth below.

American Express signs millions of foreign merchants to accept the American Express card. Approximately 98 percent of merchants in a typical region are small retail merchants that usually do not speak English. Legal agreements and all account communications are in local language . . . When American Express recently surveyed its merchant account information data, less than 1 percent of active foreign merchants have a U.S. address on record.²⁶

²⁴ The proposed and final section 6050W regulations imposed this standard on U.S. payors when the regulations under section 1441, which were harmonized with the reporting rules under section 6041 et seq. and backup withholding under section 3406, include presumption rules under Treas. Reg. § 1.1441-(b)(3)(iii) to determine U.S. or foreign status in the absence of documentation. It is puzzling why the proposed and final section 6050W regulations impose such a burdensome standard when the same standard is not used in this other context.

²⁵ The rules set forth in section 6050W(b)(4)(B) shift the documentation and reporting requirements to intermediaries that qualify as Electronic Payment Facilitators ("EPFs"). If an EPF is foreign, it may rely on the foreign address of foreign payees and need not obtain documentation from the payee. U.S. payors could separate themselves from payments to foreign payees by using a foreign EPF for foreign payees. Although this approach would allow a U.S. payor to avoid the documentation requirements for foreign payees, the use of an EPF could be detrimental to business relationships and increase costs considerably. More importantly for Treasury and the IRS, however, this approach would remove U.S. payors from the payment chain and thwart efforts to identify U.S. tax evasion. Making documentation requirements reasonable for U.S. payors in a manner that encourages the monitoring of indicia of U.S. status for foreign payees would seem to be more advantageous for the U.S. fisc than encouraging an approach that bifurcates the documentation and payment processes simply to allow U.S. payors to sidestep an unreasonable documentation standard that ultimately allows reliance on the foreign address anyway.

²⁶ Testimony of Anne Pontrelli, Vice President and General Tax Counsel for American Express.

[t]he average merchant will not easily understand or accept, notwithstanding our educational efforts, that the Form W-8BEN is not asking for any information that Elavon most likely has in its account information; that the form will not result in unanticipated and unwarranted tax consequences to the merchant; or that Elavon will not provide the form or its information to the IRS or any government body, foreign or domestic. The merchant will see that it's a United States tax form and . . . will be highly resistant to completing and providing the form to us.²⁷

First Data provides services to over two million merchants located outside the U.S. . . . This requirement would hurt our ability and the ability of other companies like us to compete in foreign markets. In essence, the proposed regulation as written will cripple U.S. payor's attempts to compete outside the U.S. in the merchant economy space.²⁸

In addition to testimony given at the Hearing, Treasury and the IRS received significant feedback regarding the harm caused by this rule, including written comments from U.S. payors that would be directly and adversely affected.²⁹ IRPAC believes that the concern raised by these U.S. payors is accurate and justified. Although it is important to curtail U.S. tax evasion and narrow the tax gap, it is also critical to maintain competitive parity among market participants. It makes little sense to implement a standard that will doom the competitiveness of U.S. business in foreign markets. Accordingly, IRPAC strongly recommends that the rule set forth in Treas. Reg. § 1.6050W-1(a)(5) for U.S. payors be promptly revised in such a manner that U.S. payors and non-U.S. payors are afforded the same treatment in order to maintain competitive parity between U.S. payors and non-U.S. payors. Specifically, IRPAC recommends that the standard currently applied to non-U.S. payors under Treas. Reg. § 1.6050W-1(a)(5)(ii)(B) apply to both U.S. and non-U.S. payors so that both may rely on the foreign address of a foreign payee, absent any indication that the payee may be a U.S. person.

VI. COMPLIANCE BURDEN, PENALTY RELIEF, AND THE NEED TO EXTEND THE EFFECTIVE DATES FOR BOTH SECTION 6050W REPORTING AND BACKUP WITHHOLDING

IRPAC believes that the implementation of section 6050W reporting is so significant that it is unlikely that many of those subject to these rules, particularly in the context of third party network transactions, will be able to timely comply by the current effective dates. It is unlikely, if not impossible in many cases, for business software providers and the IT functions of reporting organizations to develop and test software that

²⁷ Testimony of Stuart Harvey, Chief Executive Officer of Elavon.

²⁸ Testimony of Mark Waring, Vice President of Compliance for First Data.

²⁹ For example, the American Bankers Association submitted detailed comments on this issue on January 25, 2010.

conforms to the rules in sufficient time to allow for reasonable compliance with the section 6050W rules. Further, significant open questions exist under the final section 6050W regulations that require additional consideration and attention before these rules should be implemented.

For the reasons set forth herein, IRPAC believes that to persist with the current effective dates when so many reporting organizations cannot reasonably comply makes little sense and is unreasonable. Accordingly, IRPAC strongly urges the postponement of the current effective dates for both reporting and backup withholding by at least one additional year, or otherwise make the reporting optional for 2011 and 2012, at least with respect to third party payment networks that have historically reported payments on Form 1099-MISC. And even with such an extension of time, IRPAC urges the adoption of a much more lenient standard for penalty relief during the transition period to section 6050W reporting than the traditional reasonable cause standard.

IRPAC appreciates the opportunity to comment on the important issues addressed herein raised by the Form 1099-K and the promulgation of the final section 6050W regulations. Please do not hesitate to contact us if you have any questions or need additional information.

Sincerely,

A handwritten signature in cursive script, appearing to read "Elizabeth Thomas Dold".

Elizabeth Thomas Dold
IRPAC Chair

Appendix E

Announcement 2010-22: Request for Comments Regarding Implementation of FATCA

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7563, Washington, D.C. 20224

Elizabeth Thomas Dold,
Chairperson

September 15, 2011

Burden Reduction

Sub-Group:

Kathy Ploch, Chair
Julia Chang
Kathryn Tracy
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Internal Revenue Service
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**Emerging Compliance
Issues**

Sub-Group:

Candace Ewell, Chair
Susan Boltacz
Rebecca Harshberger
Anne Jetmundsen
Jerri Langer

**Re: Announcement 2010-22: Request for Comments Regarding
Implementation of FATCA**

Employee

Benefits/Payroll

Sub-Group:

Leonard Jacobs, Chair
Lisa Germano
Tony Lam
Anne Lennan
Emily Lindsay
Michael Lloyd

Dear Commissioner,

Pursuant to the Internal Revenue Service's request for comments in Announcement 2010-22, the Information Reporting Program Advisory Committee ("IRPAC") would like to provide comments regarding an issue arising under section 502 of the Hiring Incentives to Restore Employment Act of 2010 (the "HIRE Act"). The repeal of section 163(f)(2)(B) of the Internal Revenue Code ("Code") by section 502 of the HIRE Act has indirectly led to some uncertainty regarding whether U.S. issuers will be able to continue to rely on the long-standing information reporting exemption under section 6049 relating to short-term debt such as commercial paper.

As more fully discussed below, IRPAC strongly believes that the enactment of the HIRE Act was not intended to affect this exemption, and recommends that the Service modify Treasury Regulation section 1.6049-5(b)(10) to eliminate this uncertainty, or otherwise confirm that this exemption will remain in effect, in order to avoid confusion and possible market disruption.

Background. The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") enacted restrictions on U.S. issuers' ability to issue debt instruments in bearer form, in order to increase compliance by limiting the circumstances in which ownership of debt instruments was not reflected by some sort of book-entry registration system. However, in order to preserve liquidity in the financial markets, TEFRA enacted certain targeted exceptions to the bearer bond restrictions, including (i) the so-called "Eurobond exception," pursuant to which debt instruments may be issued in bearer form as long as they are sold under arrangements reasonably designed to ensure that the instruments are sold only to non-U.S. persons; and (ii) an exception

**International Reporting &
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for debt having an original term to maturity of one year or less (the "short-term exception").¹

Section 502 of the HIRE Act repealed Code section 163(f)(2)(B), effective for debt issued after March 18, 2012. Thus, in general, U.S. issuers no longer will be permitted to issue debt instruments in bearer form even if their distribution is targeted to non-U.S. persons. However, the HIRE Act did not repeal the short-term exception in Code section 163(f)(2)(A)(iii).² Thus, even after March 18, 2012, U.S. issuers will be permitted to issue short-term debt in bearer form.

Section 6049 Short-Term Debt Exemption. The regulations under section 6049 include an exemption from information reporting for debt instruments that have an original term to maturity of 183 days or less³ and that satisfy a number of other requirements that are intended primarily to ensure that the debt is not held by U.S. non-exempt recipients. Those requirements include the following:

- 1) Payments on the instrument must be made outside the United States.
- 2) The instrument must have a principal amount of not less than \$500,000.
- 3) The instrument generally must satisfy "the requirements of sections 163(f)(2)(B)(i) and (ii)(I) and the regulations thereunder" – *i.e.*, the issuance of the instrument must satisfy the requirements of the Eurobond exception described above.
- 4) The instrument must bear a specified legend stating that the holder represents that it is not, and does not hold on behalf of, a U.S. person that is a non-exempt recipient.
- 5) If the instrument is in registered form, it must be registered in the name of an exempt recipient.

¹ The Eurobond exception is in Code section 163(f)(2)(B); the short-term exception is in Code section 163(f)(2)(A)(iii). The Joint Committee on Taxation described the adoption of these exceptions as follows:

Congress also recognized the importance of preserving liquidity in the financial markets. Thus, a flexible book-entry system of registration was permitted and exceptions from the registration requirements were provided for short-term obligations . . . and for certain obligations issued abroad.

See Joint Committee on Taxation, "General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982" (December 31, 1982), page 190.

² The Joint Committee on Taxation's description of the repeal of the Eurobond exception makes it clear that the retention of the short-term exception was not an oversight, but rather that the exception was clearly intended to remain in effect. See Joint Committee on Taxation, "Technical Explanation of The Revenue Provisions Contained in Senate Amendment 3310, The 'Hiring Incentives To Restore Employment Act,' Under Consideration By The Senate" (February 23, 2010), page 52.

³ Debt instruments having a term to maturity of more than 183 days generally may be exempt from information reporting under the "portfolio interest" exemption. See Treasury Regulation sections 1.6049-5(b)(7) and (8).

Because the HIRE Act repealed Code section 163(f)(2)(B), effective for instruments issued after March 18, 2012, one possible interpretation of the regulation described above is that issuances of short-term debt after that date cannot satisfy the third requirement – that the instrument satisfy the requirements of Code section 163(f)(2)(B) – since it may not be possible to satisfy the requirements of a Code section that has been repealed. There is no indication in either the text of the HIRE Act or in the Joint Committee on Taxation's report cited in footnote 2 that Congress intended to eliminate U.S. issuers' ability to rely on the long-standing information reporting exemption for short-term debt when it repealed the Eurobond exception. In fact, as noted above, although Congress repealed the Eurobond exception in Code section 163(f)(2)(B), it retained the exception for short-term debt in Code section 163(f)(2)(A), indicating that Congress intended to leave the treatment of short-term debt unchanged.⁴

Treasury Regulation section 1.6049-5(b)(10) was adopted to facilitate U.S. borrowers' ability to access needed funding, while providing safeguards to minimize the likelihood that instruments eligible for exemption would be held by non-exempt U.S. persons. The HIRE Act's repeal of U.S. issuers' ability to issue long-term debt in bearer form does not in any way implicate that policy decision. The issue arises simply because the section 6049 regulations cross-reference the statutory Eurobond exception as a short-hand way to incorporate foreign-targeting procedures into the information reporting exception.

Although it is possible to interpret Treasury Regulation section 1.6049-5(b)(10)'s cross-reference to section 163(f)(2)(B) in a manner that would retain the viability of the information reporting exemption following the effective date of section 502 of the HIRE Act, it is important that the issue be clarified in order to avoid possible disruption in the commercial paper market. Thus, IRPAC strongly recommends that the Service revise this section of the Treasury Regulations to expressly confirm this interpretation, or otherwise provide some confirmation that the enactment of the HIRE Act did not effectively eliminate the information reporting exemption for commercial paper. If the Service were to modify the regulations, a number of alternative approaches would be available. For example, the cross-reference to section 163(f)(2)(B) could be (i) revised to refer to that section as in effect prior to its repeal by the HIRE Act, (ii) revised to refer to the Treasury Regulations that implement the Eurobond exception, which may remain in effect even after the repeal of section 163(f)(2)(B) is effective,⁵ or (iii) eliminated and replaced with the substantive provisions currently included in Treasury Regulation section 1.163-5(c)(2).

⁴ The HIRE Act's lack of language calling into question the continued viability of the regulations under Code section 6049 stands in marked contrast to the explicit language overriding existing regulations under Code section 6041 in section 9006(a) of the Patient Protection and Affordable Care Act, which was enacted less than two weeks after the HIRE Act.

⁵ Treasury Regulation section 1.163-5(c)(2) describes the circumstances under which an issuance of debt instruments will be treated as satisfying Code section 163(f)(2)(B)'s requirement that debt instruments be issued under "arrangements reasonably designed" to ensure that they are sold only to non-U.S. persons. Although the HIRE Act repealed Code section 163(f)(2)(B), the principles of these regulations continue to be relevant for purposes of the excise tax imposed by section 4701, which also provides an exception for debt issued under arrangements reasonably designed to ensure that the instrument is sold only to non-U.S. persons. (The exception appears to have been retained for excise tax purposes principally to clarify that debt issued outside the United States

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Importantly, as noted above, the repeal of section 163(f)(2)(B) will be effective for instruments issued after March 18, 2012. Thus, it is important that this issue be clarified as soon as possible to avoid potential disruption in U.S. borrowers' ability to access needed sources of funding.

Respectfully submitted,



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2011 IRPAC Chair

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by non-U.S. issuers generally is not subject to penalties under TEFRA's anti-bearer bond rules.) Thus, notwithstanding the repeal of Code section 163(f)(2)(B), Treasury and the Service should retain Treasury Regulation section 1.163-5(c)(2). Because those regulations will only be effective with respect to the exemption under Code section 4701, consideration should be given to reclassifying the regulations as being issued under that section or revising Treasury Regulation section 46.4701-1(b)(3)'s cross-reference to section 163(f) to clarify that the procedures described in Treasury Regulation section 1.163-5(c)(2) continue to be relevant for purposes of Code section 4701.

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Information Reporting Program Advisory Committee 2011 Member Biographies

- Susan R. Boltacz** Ms. Boltacz, a CPA and attorney, is Group Vice President, Tax Counsel and Director of Tax Information Reporting at Sun Trust Bank in Atlanta, Georgia. She has been advising on tax information reporting issues and implementing tax information reporting requirements for financial services and telecommunications industries for over 21 years. Ms. Boltacz is a member of the Tax Section of the American Bar Association and an IRS VITA Program Volunteer. She became the first woman member of the Advisory Board, Georgia State College of Law Tax Clinic in 2008. She received an Honors BS in Accounting/Operations Management from Marquette University and an MBA and JD from the University of Georgia. **(Emerging Compliance Issues)**
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Mr. Coppinger is a member of the Tax Section and the Personal Financial Specialist Section of the AICPA, and the IRS Relations Committee of the New York State Society of CPAs. He has co-authored articles in publications such as The Journal of Bank Taxation, Practical Tax Strategies and The AICPA Tax Adviser. He is an adjunct associate professor at St. John's University's Tobin College of Business where he teaches graduate courses in IRS Practice and Procedure, Federal Tax Research and Tax Research and Writing. Mr. Coppinger received his BS in Finance and MBA in Public Accounting from St. John's University and MS in Taxation from Pace University. **(International Reporting and Withholding)**

Elizabeth T. Dold

Ms. Dold is a Principal Attorney in the Groom Law Group in Washington, DC. For over ten years her work has focused on employee benefits and compensation matters, including the related reporting and withholding requirements. She regularly advises Fortune 500 companies (including corporate and tax-exempt employers, financial institutions and third party administrators) on plan qualification and employment tax issues. She is a member of the American Society of Pension Professionals and Actuaries (ASPPA) and chair of their IRS subcommittee. Ms. Dold is the Chief Benefits Counsel for linksinpink and a former adjunct professor at Georgetown Law Center. She has a BS in Accounting from the Pennsylvania State University, a JD from Dickinson School of Law and an LL.M. in taxation from New York University School of Law. **(IRPAC Chairperson)**

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Ms. Ewell is a Tax Director at PricewaterhouseCoopers LLP in Washington, DC where she works with clients to ensure information reporting and withholding compliance. Prior to this position, she worked for the U.S. Small Business Administration Office of Advocacy for two years, as Assistant Chief Counsel for Tax and Pension Policy. Ms. Ewell worked in the Office of Associate Chief Counsel (Corporate) at IRS for four years as an Attorney Advisor. She received her J.D. from North Carolina central University School of Law and Her LL.M. in taxation from Georgetown University Law Center. **(Chair, Emerging Compliance Issues)**

Lisa Germano

Ms. Germano is President, General Counsel and co-founder of the Actuarial Benefits & Design Company in Midlothian, VA. She is experienced working with employee benefits reporting and disclosure. Ms. Germano is a member of American Institute of Certified Public Accountants (AICPA) where she is a member of its Financial Literacy Commission and has recently completed a three-year term as a member of its Board of Directors. She is a member of the Virginia Society of

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Certified Public Accountants where she has served as a member of its Board and Executive Committee. She is past president of the Virginia Commission on Women and Minorities in the Legal Profession. She is a member of the American Association of Attorney-CPAs, the American Society of Pension Professionals and Actuaries and the Virginia Women Attorneys' Association. Ms. Germano is an Attorney and Certified Public Accountant in the Commonwealth of Virginia and earned a BBA in Accounting from Iona College and a JD from Ohio Northern University. **(Employee Benefits/Payroll)**

Rebecca Harshberger

Ms. Harshberger is VP, Finance and Tax, Administrative Services, Inc. in Burbank, California. She has over 10 years experience in tax information reporting working for a company with over 85 clients reporting payroll taxes in all 50 states. She works directly with state, federal and foreign revenue agencies, state unemployment insurance agencies and motion picture studio tax departments to ensure payroll and information reporting compliance for film credits and incentives. Ms. Harshberger is on the Board of directors of the Los Angeles Chapter of the American Payroll Association. She is a member of APA, a Certified Payroll Professional and teaches the LA CPP prep course. She has a BS in Business Administration from San Diego State University. **(Emerging Compliance Issues)**

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products. He addresses the legal requirements of tax information reporting and withholding for millions of investor accounts and retirement plan participant accounts both domestic and foreign. He is a member of the firm's steering committee, advising on cost basis reporting. Mr. Lam is a member of the Investment Company Institute's Tax Committee. He received a BA from the University of Hong Kong, an LLB from the University of London, a JD from Seton Hall University and an LLM in taxation from New York University. **(Employee Benefits/Payroll)**

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Ms. Langer is a founding member of Cokala Tax Information Reporting Solutions in Ann Arbor Michigan. She is an information reporting and withholding consultant who provides a wide range of tax advisory services to many Fortune 500 companies around the world. She was a founding member of the National Association of Tax Reporting and Payroll Management (NATRPM), serving as the Government Relations Coordinator on the Board of Directors. This is her second IRPAC appointment; she previously served in 1999-2000. Ms. Langer authors the AAPA Guide to Accounts Payable, the Aspen Publishers' Ohio Payroll Guide and the California Payroll Guide as well as contributes to Aspen's The Payroll Answer Book, all widely circulated publications. Ms. Langer has a BA, a JD and LLM in Taxation from the University of Florida and is a member of the Michigan and Florida Bars. **(Emerging Compliance Issues)**

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Ms. Lennan is President of the Society of Professional Benefit Administrators in Chevy Chase, MD, which represents 300 Third Party Administration employee benefit firms across the US. She has over 20 years experience as an advisor to employee benefit plans and a liaison between TPA firms and federal government agencies. She has worked on benefit issues impacting large corporations, small businesses, union plans, state and local government plans, and association-sponsored plans. Ms. Lennan is a member of Women in Government Relations and the International Society of Certified Employee Benefit Specialists. She co-founded an educational software company. She has a BA from Vanderbilt University, and is a Certified Employee Benefit Specialist. **(Employee Benefits/Payroll)**

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Ms. Lindsay is Director of the Master of Science in Accounting Program at American University, Kogod School of Business, where she also teaches graduate and undergraduate accounting courses. She worked for Marriott International, Inc. in Bethesda, MD for over 20 years where she was Vice President, Corporate Accounting Services. She is a member and Vice President of the American Payroll Association and past chair of their Legislative Issues Committee and Subcommittee on New Technology. Ms. Lindsay is a member of the Maryland Association of

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Certified Accountants. She is a past member of the IRS Electronic Tax Administration Advisory Committee (ETAAC) and the IRS Advisory Council (IRSAC). She is a CPA and has a BA from Dickinson College and a MS in Accounting from American University. **(Employee Benefits/Payroll)**

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Mr. Lloyd is Member in the law firm of Miller & Chevalier Chartered in Washington, DC. He advises large businesses and tax-exempt organizations on a range of tax issues, including cross-border withholding and reporting, domestic information reporting and backup withholding, employment taxation, the treatment of fringe benefits, executive compensation, and penalty abatement. Mr. Lloyd is a member of the American Bar Association, Section of Taxation, and was honored as a John S. Nolan Fellow in 2005. He regularly speaks before organizations such as the Tax Executives Institute and the American Payroll Association. He received a B.S. in accounting from Mount St. Mary's College, and a J.D. (Order of the Coif, Order of Barristers) from the University of Maryland School of Law. **(Employee Benefits/Payroll)**

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Ms. Penrod is a Managing Director in the Corporate Tax Department at JP Morgan Chase in New York, New York. She manages the IRS Information Reporting and Withholding Tax Advisory Function for the firm and its worldwide affiliates. In this role, Ms. Penrod establishes and coordinates tax policy across all business lines to ensure consistent tax

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treatment of all products and transactions. She is also responsible for monitoring withholding tax legislative and regulatory developments. This is Ms. Penrod's second IRPAC appointment; she previously served from 1994-1996. Ms. Penrod is a member and past chair of the Clearing House Association Tax Withholding and Reporting Committee, and the Securities Industry & Financial Markets Association Tax Administration Committee. She has a BS from the Pennsylvania State University. **(International Reporting and Withholding)**

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Ms. Ploch is a Tax Manager for Zientek & Company, PC in Houston Texas. She has worked in public accounting for 27 years and is a CPA and Certified Payroll Professional (CPP). She is a member and Past President of the Houston CPA Society. She is a board member of the Texas Society of Certified Public Accountants. Ms. Ploch is also a member of the American Payroll Association and the American Institute of Professional Bookkeepers. She has a BBA in Accounting from the University of Houston. **(Chair, Burden Reduction)**

Kathryn S. Tracy

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Mr. Wolk is a Senior Vice President at SunGard Wall Street Concepts in New York, New York. He has over twenty years of experience in tax information reporting, specializing in securities operations. He is a member of the Dividend Division of the Securities Industry and Financial Markets Association. Mr. Wolk received his BA in Economics from the State University of New York at Binghamton. **(Burden Reduction)**

Lonnie Young

Mr. Young is a CPA and has been the owner of Young & Company, LLC since 1982 in Lake Mary, Florida. He received an award from IRS for his firm's exemplary performance as an Electronic Return Originator in 2004. His firm prepares corporate, partnership, trust and individual returns as well as payroll information returns. He is a member of the AICPA and the National Society of Accountants. Mr. Young received a BSBA from the University of Arkansas and his MBA from the University of Utah. **(Burden Reduction)**

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